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Installment Land Contracts—The National Scene Revisited†

*Grant S. Nelson**
*Dale A. Whitman***

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In 1977 we published an article in this Review that discussed the legal aspects of the installment land contract.¹ The installment contract was then, and continues to be, widely used as a device for seller financing of real estate. In our judgment, and increasingly in the judgment of the courts, that is a mistake. Few situations, if any, would lead an informed lawyer to advise his client to use an installment contract rather than its financing cousin, the note secured by a mortgage or deed of trust.

Since the prior article was published, the courts have continued to place impediments in the path of the vendor who must realize on the security of the contract. The law has grown increasingly complex and disadvantageous to vendors. The installment contract device persists only because of a lack of understanding by buyers, sellers, and brokers, and because most such transactions occur without a lawyer's involvement. Unfortunately, the role of counsel is typically to "pick up the pieces" after the contract has been executed and default has occurred.

In the present article we give renewed attention to the familiar problems covered in our prior work and focus on several new issues. In particular, we focus on issues relating to the parties' use of their contract rights as security for further financing, the rights of creditors of the parties, and recent developments in bankruptcy and federal income tax law. More than half of the material is new, but readers acquainted with the previous article will find that much of its structure and analysis survives.

I. AN INTRODUCTION TO THE INSTALLMENT LAND CONTRACT

The installment land contract is the most common substitute for the mortgage or deed of trust. It is also sometimes referred to as a "contract for deed," a "long-term land contract," or a "land sale contract." The installment land contract and the purchase money mortgage fulfill the identical economic function: permitting the seller to finance the unpaid portion of the real estate purchase price. Under the installment land contract, the vendee normally takes possession and makes monthly installment payments of principal and interest until the principal is paid off. The vendor retains legal title until the final payment is made, at which time full title is conveyed to the vendee. Such contracts may be amortized over time periods as short as a year

1. Nelson & Whitman, *The Installment Land Contract—A National Viewpoint*, 1977 B.Y.U. L. Rev. 541.

or as long as more than twenty years. During the contract period, the vendee normally will be required to pay taxes, maintain casualty insurance, and keep the premises in good repair.

The installment land contract must be distinguished from the ordinary executory contract for the sale of land, variously known as an "earnest money contract," a "binder," or a "marketing contract." The earnest money contract is used primarily to establish the parties' rights and liabilities during the period between the date of the bargain and the date of closing. This period is usually only a month or two. At the end of the period title passes to the purchaser and security agreements, if any, are consummated. While the earnest money contract is completed at closing when the purchaser either tenders the full purchase price of the land or enters into a separate security agreement, the installment land contract governs the parties throughout the life of the debt. Indeed, it is not uncommon for parties to agree to enter into an installment land contract at the closing date of the earnest money contract.

Traditionally the vendor in an installment land contract has relied primarily on a forfeiture clause. The forfeiture clause, found in virtually every installment contract, typically provides that "time is of the essence" and that when a vendee fails to comply with the contract, including the obligation to pay promptly, the vendor has the option to declare the contract terminated. The vendor can then take possession of the premises without legal process and can retain all prior payments as liquidated damages. Generally, the clause also relieves the vendor from all further obligations under the contract.

As one commentator has aptly pointed out, "If the contract is enforceable as written and if title will not be clouded, [the installment land] contract gives the vendor a very favorable remedy, much more advantageous than would be available under a purchase money mortgage or deed of trust."² Indeed, under a mortgage or deed of trust, the defaulting mortgagor has a right to redeem (the equity of redemption) which the mortgagee can eliminate only by a foreclosure proceeding should the mortgagor prove to be uncooperative.³ Furthermore, in many states the

2. Comment, *Installment Contracts for the Sale of Land in Missouri*, 24 Mo. L. Rev. 240, 244 (1959); see also Comment, *Forfeiture: The Anomaly of the Land Sale Contract*, 41 ALB. L. REV. 71, 73-74 (1977).

3. See G. NELSON, & D. WHITMAN, REAL ESTATE FINANCE LAW §§ 7.1-7.5 (2d ed. 1985) [hereinafter cited as NELSON & WHITMAN].

mortgagor has postsale statutory redemption rights even after a foreclosure sale.⁴ Conversely, the forfeiture clause in an installment land contract appears to give the vendor an efficient remedy unfettered by such equitable and statutory mortgagor protections. However, it is important to emphasize that if the vendee resists forfeiture, the installment land contract is advantageous only if it is enforceable as written and if title will not be clouded.

Installment land contracts have traditionally been used as mortgage substitutes in those states where the substantive law of mortgages and the procedural aspects of foreclosure are considered promortgagor. For example, in many states, judicial foreclosure is the only method of foreclosing a mortgage.⁵ Judicial foreclosure, often a time-consuming and costly procedure, requires a full court proceeding in which all interested persons must be made parties. Against a mortgagor who contests the mortgagee's claims, it may take several years to conclude such an action. Thus, utilization of the installment land contract in such states, whatever its risks, is perhaps understandable. But the risks are high, as we will show below.

II. THE FORFEITURE REMEDY—SOME GENERAL CONSIDERATIONS

Traditionally installment land contract forfeiture provisions were routinely enforced in favor of the vendor.⁶ The courts presumably based enforcement of such provisions on a desire to carry out the intent of the parties, even though forfeiture often resulted in a substantial loss to the vendee and a windfall gain to the vendor.⁷ Enforcement became especially burdensome on the vendee as the contract neared completion and the vendee's cash investment increased. Courts tended to ignore the mortgage substitute aspect of the installment land contract and to treat it instead as an executory contract for the sale of land.

However, during the past several decades, an increasing number of courts and legislatures have focused on the installment land contract and its forfeiture clause with a mortgage law analogy in mind. One court recently asked, "If [the absolute

4. See *id.* §§ 8.4-8.7.

5. See *id.* § 7.11.

6. See Note, *Forfeiture and the Iowa Installment Land Contract*, 46 IOWA L. REV. 786, 788 (1961); Comment, *Florida Installment Land Contracts: A Time for Reform*, 28 U. FLA. L. REV. 156, 159 (1975).

7. Note, *supra* note 6, at 788.

deed] kind of forfeiture may not be enforced by the secured party according to the express terms of the agreement, why, then, should a forfeiture under a land sale contract be so enforced?"⁸ The foregoing process, however, has not produced either an analytical or practical consensus. Consequently, the law in this area is not susceptible to orderly analysis. "Not only does the law vary from jurisdiction to jurisdiction, but within any one state results may vary depending upon the type of action brought, the exact terms of the land contract, and the facts of the particular case."⁹ The interplay of these factors makes predicting whether the vendee's interest will be forfeited extremely difficult. While forfeitures are still occasionally judicially enforced,¹⁰ no jurisdiction will automatically enforce a forfeiture provision as it is written.¹¹ This change is the result of legislative and judicial intervention to ameliorate the harsh impact of automatic forfeiture.

III. STATUTORY LIMITATIONS ON FORFEITURE

Several states have attempted to alleviate some of the harshness in forfeiture clauses by enacting legislation regulating the circumstances under which forfeiture will be permitted. These statutes often incorporate a "grace period" within which late payments must be accepted. Perhaps the best example of this type of legislation is the Iowa statute.¹²

The Iowa statute provides that installment land contracts may be canceled only by a specified procedure. The vendor must provide written notice to the defaulting vendee and to the per-

8. *Braunstein v. Trottier*, 54 Or. App. 687, 692, 635 P.2d 1379, 1382 (1981).

9. Power, *Land Contracts as Security Devices*, 12 WAYNE L. REV. 391, 416 (1966) (footnotes omitted).

10. See *Hamner v. Rock Mountain Lake, Inc.*, 451 So. 2d 249 (Ala. 1984); *Bell v. Coots*, 451 So. 2d 268 (Ala. 1984); *Curry v. Tucker*, 616 P.2d 8 (Alaska 1980); *Ellis v. Butterfield*, 98 Idaho 644, 570 P.2d 1334 (1977); *McEnroe v. Morgan*, 678 P.2d 595 (Idaho App. 1984); *First Nat'l Bank v. Cape*, 100 N.M. 525, 673 P.2d 502 (1983); *Jacobs v. Phillippi*, 697 P.2d 128 (N.M. 1985); *Albuquerque Nat'l Bank v. Albuquerque Ranch Estates, Inc.*, 99 N.M. 95, 654 P.2d 548 (1982); *Braunstein v. Trottier*, 54 Or. App. 687, 635 P.2d 1379 (1981); *Stonebraker v. Zinn*, 286 S.E.2d 911 (W. Va. 1982). Cf. *United States v. Winterburn*, 749 F.2d 1283 (9th Cir. 1984).

11. Even in states that otherwise enforce forfeitures, courts will, for example, require the vendor to provide notice of intent to forfeit and a reasonable period of time "to cure the default," even though such actions are not required by the contract. See, e.g., *Martinez v. Martinez*, 101 N.M. 88, 678 P.2d 1163 (1984); *Brummett v. Sando*, 2 Wash. App. 33, 466 P.2d 187 (1970).

12. IOWA CODE ANN. §§ 656.1-656.6 (West 1950).

son in possession of the real estate. The notice must identify the real estate, specify the terms of the contract that have been violated, and inform the vendee that he has thirty days in which to correct his default. If the vendee performs within this time period, the forfeiture is avoided. If he does not, the notice of forfeiture, together with proof of service, may be recorded to constitute constructive notice of the completed forfeiture. Several other states have statutes similar to those of Iowa;¹³ the grace period varies from thirty days in Iowa to as long as one year in North Dakota. In Minnesota and Arizona the grace period depends on the percentage of the contract price the vendee has paid.¹⁴ Some statutes permit nonjudicial forfeiture, while others allow foreclosure only by judicial action. The purpose of these statutes, however, is to alleviate the harshness of forfeitures, not to prevent them.¹⁵

Several observations should be made about the statutory regulations. First, as a practical matter, the statutory grace period approach is analogous to the mortgage law concept of strict foreclosure. This mortgage foreclosure method, rarely used in the United States, allows a judicial grace period during which the mortgagor either pays the mortgage debt or forfeits the land to the mortgagee.¹⁶ Similarly, if a vendee under an installment contract fails to correct a default within the statutory grace period, he loses the land. It is perhaps ironic that in some respects the statutory contract forfeiture procedures are more "pro-vendee" than the strict foreclosure concept is "pro-mortgagor." Under strict foreclosure, the mortgagor must pay the accelerated debt or lose the land. On the other hand, in states such as Iowa and Minnesota, the defaulting vendee, rather than pay the accelerated debt, need only pay the arrearages within the grace period in order to reinstate the contract.¹⁷

13. See, e.g., MINN. STAT. ANN. § 559.21 (West Supp. 1977); N.D. CENT. CODE §§ 32-18-01 to -06 (1976); S.D. CODIFIED LAWS ANN. §§ 21-50-01 to -07 (1979).

14. MINN. STAT. ANN. § 559.21 (West Supp. 1984) (90 days maximum); ARIZ. REV. STAT. ANN. §§ 33-741-742 (1956) (9 months maximum).

15. See Note, *supra* note 6, at 797; NELSON & WHITMAN, *supra* note 3, §§ 7.9-7.10.

16. See G. NELSON & D. WHITMAN, CASES AND MATERIALS ON REAL ESTATE TRANSFER, FINANCE AND DEVELOPMENT 481-482 (2d ed. 1981) [hereinafter cited as NELSON].

17. See Hampton Farmers Coop. Co. v. Fehd, 257 Iowa 555, 559, 133 N.W.2d 872, 874 (1965); Needles v. Keys, 149 Minn. 477, 480, 184 N.W. 33, 34 (1921); Comment, *Installment Land Contracts—Vendors' Remedies—Combining Acceleration and Forfeiture*, 51 IOWA L. REV. 488 (1966).

Second, to some degree these statutes have institutionalized or formalized the forfeiture concept and, in so doing, may have discouraged judicial interference in those situations where the vendor complies with the statutory forfeiture method.¹⁸ Courts in states having such statutes have suggested that relief from an "unconscionable forfeiture" may be available.¹⁹ For example, the Iowa Supreme Court has held that, notwithstanding vendee default and vendor compliance with statutory termination requirements, if the vendor himself was in default "equity dictates a cancellation of the forfeiture."²⁰ Also, statutory forfeiture may be inappropriate for certain minor, nonmonetary defaults.²¹ However, judicial intervention in statutory termination settings tends to focus more on technical statutory compliance and interpretation than on independent analysis of the fairness of forfeiture.²²

Finally, one practical advantage of statutory regulation is that it encourages the stability of land titles. Whatever the defects of statutory regulation, title examiners in many states routinely approve of the titles derived through statutory proceedings.²³ Title examiners give approval for at least two reasons. First, the courts' tendency to reject nonstatutory attacks on forfeitures encourages reliance on forfeiture proceedings that comply with the applicable statute. Second, many of these statutes provide for the recording of a written and formalized memorial of compliance with the statute.²⁴ As a result, the title examiner

18. Note, *supra* note 6, at 797; Comment, *Remedying Inequities of Forfeiture in Land Installment Contracts*, 64 Iowa L. Rev. 158 (1978).

19. See, e.g., *Jensen v. Schreck*, 275 N.W.2d 374 (Iowa 1979) (court suggests that while relief from forfeiture may be appropriate in certain situations, forfeiture was not unreasonable where vendee's contract payments and other investment in the real estate was less than five percent of the contract price).

20. *Keokuk State Bank v. Eckley*, 354 N.W.2d 785 (Iowa Ct. App. 1984); *Skubal v. Meeker*, 279 N.W.2d 23, 26 (Iowa 1979); see also *Warren v. Yocum*, 223 N.W.2d 258 (Iowa 1974).

21. See *Lett v. Grummer*, 300 N.W.2d 147 (Iowa 1981) (statutory forfeiture refused where failure to make minor repairs did not threaten security).

22. See *Miller v. American Wonderlands, Inc.*, 275 N.W.2d 399 (Iowa 1979) (upholds statutory forfeiture based on a \$10.48 default on a \$30,000 contract and vendee's allowing liens to be filed on the premises); *Conley v. Downing*, 321 N.W.2d 36 (Minn. 1982) (statutory termination valid notwithstanding misstatement of attorney's fees in notice of cancellation); *Dale v. Pushor*, 246 Minn. 254, 75 N.W.2d 595 (1956); Note, *supra* note 6, at 792. Cf. *Keokuk State Bank v. Eckley*, 354 N.W.2d 785 (Iowa Ct. App. 1984) (waiver defeats forfeiture).

23. Nelson, *The Use of Installment Land Contracts in Missouri: Courting Clouds on Titles*, 33 J. Mo. B. 161, 164 (1977).

24. The Iowa statute exemplifies such a provision:

is able to rely on the record for evidence of a permissible forfeiture. This is true even when the original contract is recorded. On the other hand, in states that lack statutory control of the forfeiture process, the recording of a statement that forfeiture has occurred may be regarded by a subsequent title examiner as a self-serving assertion that may constitute a cloud on title.

The Maryland statute takes a substantially different approach from those described above.²⁵ Forfeiture is prohibited when an installment land contract is for the sale of residential property to a noncorporate vendee. The vendor can utilize the land to satisfy the vendee's debt only through a foreclosure sale identical to that used for a mortgage.²⁶ The vendee is entitled to receive as surplus from the sale the amount by which the sale price exceeds the unpaid balance of the purchase price. Since installment land contracts in residential transactions are treated like mortgages, there is apparently no incentive to continue their use in the residential setting. On the other hand, common law forfeiture rules presumably still apply to nonresidential installment land contracts.²⁷

The Ohio legislation governing installment land contracts is also somewhat unique. While it incorporates a grace period concept, it focuses on how long and how much the vendee has paid under the contract. The statute categorizes contracts on "property improved by a dwelling" in two ways: (1) those which have been in effect less than five years *and* on which less than twenty percent of the principal amount has been paid, and (2) those which have been in effect five years or more *or* on which twenty percent or more has been paid. In the former setting, forfeiture,

If the terms and conditions as to which there is default are not performed within said thirty days, the party serving said notice or causing the same to be served, may file for record in the office of the county recorder a copy of the notice aforesaid with proofs of service attached or indorsed thereon (and, in case of service by publication, his personal affidavit that personal service could not be made within this state) and when so filed and recorded, the said record shall be constructive notice to all parties of the due forfeiture and cancellation of said contract.

IOWA CODE ANN. § 656.5 (West 1950).

25. MD. REAL PROP. CODE ANN. §§ 10-101 to -108 (1974); MD. RULES W79.

26. MD. RULES W70-W72, W77.

27. See also MONT. REV. CODE ANN. §§ 52-401 to -417 (Supp. 1975), in which the Montana Small Tract Financing Act of 1963 made possible an optional power of sale deed of trust mechanism for tracts of 15 acres or less. One commentator has suggested that this legislation makes the installment land contract in Montana unnecessary. See Lohn, *Toward Abolishing Installment Land Sale Contracts*, 36 MONT. L. REV. 110 (1975).

while subject to a thirty-day grace period, is specifically authorized.²⁸ In the latter situation, the contract must be foreclosed judicially.²⁹ Installment land contracts that fall into neither of the above categories are governed solely by case law. Interestingly, those Ohio contracts on which forfeiture is statutorily authorized may be falling prey to the institutionalization process described earlier. According to one commentator, it is likely in such cases

that a court will grant forfeiture as a matter of law rather than exercise its equitable jurisdiction and consider factors normally used . . . in non-statutory forfeiture cases . . . [T]he vendee subject to statutory forfeiture may find himself faced with a judge who either feels constrained by the statute from granting equitable relief or takes comfort in the simplicity of the statute and ignores the possibility of equitable action.³⁰

Oklahoma legislation is perhaps the most sweeping and decisive statutory regulation of installment land contracts. In one relatively short paragraph, an Oklahoma statute states that installment land contracts

for purchase and sale of real property made for the purpose or with the intention of receiving the payment of money and made for the purpose of establishing an immediate and continuing right of possession of the described real property, whether such instruments be from the debtor to the creditor, or from the debtor to some third person in trust for the creditor, shall to that extent be deemed and held mortgages, and shall be subject to the same rules of foreclosure and to the same regulations, restraints and forms as are prescribed in relation to mortgages.³¹

The effect of this statutory provision is to treat all installment land contracts entailing a transfer of possession to the vendee as mortgages and thus make the forfeiture remedy unavailable to a vendor. Thus, installment land contracts presumably have been rendered obsolete in Oklahoma. This legislation is especially sig-

28. OHIO REV. CODE ANN. §§ 5313.05, 5313.06, 5313.08 (Page 1981).

29. OHIO REV. CODE ANN. § 5313.07 (Page 1981).

30. Durham, *Forfeiture of Residential Land Contracts in Ohio: The Need for Further Reform of a Reform Statute*, 16 AKRON L. REV. 397, 430 (1983).

31. OKLA. STAT. ANN. tit. 16 § 11A (West Supp. 1984). See *Panama Timber Co., Inc. v. Barsanti*, 633 P.2d 1258 (Okla. Ct. App. 1981) (installment land contract deemed constructive mortgage).

nificant since Oklahoma permits only judicial, and not power of sale, foreclosure of mortgages.³²

IV. JUDICIAL LIMITATIONS ON FORFEITURE

Absent statutory regulation, numerous state courts have refused to enforce forfeiture clauses deemed unreasonable or inequitable. These courts have employed several approaches to save the vendee from forfeiture. Some courts, for example, have permitted the vendee to tender the remainder of the purchase price, or even his arrearages, in a suit or counterclaim for specific performance of the contract. When the vendee is unable or unwilling to redeem, courts have occasionally ordered the judicial foreclosure of the land contract. Some courts, after determining that a particular forfeiture clause is unfair, have extended to the defaulting vendee the right to restitution—the right to recoup his payments to the extent that they exceed the vendor's damages caused by the vendee's default.

Of course, many state courts have not considered the forfeiture clause in all of the remedial contexts described above, nor have they always been theoretically precise. Some courts have utilized contract principles to protect the defaulting vendee from an inequitable forfeiture provision and other courts have gone a long way toward simply treating the installment land contract as a mortgage—in a manner similar to the Oklahoma statute. Still others have employed a confusing amalgam of mortgage and contract law. This section examines various approaches employed by state courts to mitigate the harshness of forfeiture.

A. Waiver by the Vendor as an Excuse for Delinquency

Frequently a vendor will accept one or several late payments from the vendee without taking action to declare a forfeiture. When the vendor finally runs out of patience and informs the vendee that forfeiture has occurred, the vendee may argue that the vendor's prior behavior constitutes a waiver of the time provisions of the contract and that the vendor is legally bound to accept the late payments. This dispute often surfaces in a vendee's suit or counterclaim for specific performance of the

32. OKLA. STAT. ANN. tit. 12 § 686 (West 1960). For an analysis of the statute, see Comment, *The Decline of the Contract for Deed in Oklahoma*, 14 TULSA L.J. 557 (1979).

contract. The vendee may be willing to tender the entire purchase price, or he may insist upon an opportunity to make up his arrearages and resume the original payment schedule.

Many courts have adopted the vendee's position in this situation.³³ In effect, these courts hold that the vendor's waiver avoids the effect of the forfeiture clause and creates in the vendee a right analogous to an equity of redemption. According to this view, if the vendor had given the vendee clear notice that no further delinquencies would be tolerated, and if this notice had been given in adequate time to allow the vendee to get back on schedule, the vendor might thereby have preserved his right of forfeiture as to future installments. Since the vendor did not do so, the court itself will generally fix a reasonable time within which the vendee must cure the delinquencies.

The courts of Missouri and Utah have been particularly inclined to employ this technique. One commentator aptly described the Missouri situation:

Thus, Missouri courts today seem hesitant to give full effect to forfeiture provisions as measures of liquidated damages in installment land contracts. They are likely to find that such provisions have been waived by the vendor due to such acts as his acceptance of late payments of principal or of interest on late payments after the delinquency of those payments. Furthermore, waiver of forfeiture provisions is equally likely to be found in any of the following in which a land installment contract is involved: viz., an action for ejectment by a vendor, an action for specific performance by a defaulting vendee, a counterclaim for specific performance by a defaulting vendee who is defendant to an action for ejectment, or even a trespass action by a defaulting vendee against his vendor concerning the land that is the subject of the contract. The finding that such a for-

33. See *In re Northern Ill. Dev. Corp.*, 309 F.2d 882 (7th Cir. 1962), *cert. denied*, 372 U.S. 965 (1963); *Jahnke v. Palomar Fin. Corp.*, 22 Ariz. App. 369, 527 P.2d 771 (1974); *Triplett v. Davis*, 238 Ark. 870, 385 S.W.2d 33 (1964); *Welch v. Cooper*, 670 S.W.2d 454 (Ark. Ct. App. 1984); *Peterson v. Ridenour*, 135 Cal. App. 2d 720, 287 P.2d 848 (1955); *Woods v. Monticello Dev. Co.*, 656 P.2d 1324 (Colo. Ct. App. 1982); *Krentz v. Johnson*, 36 Ill. App. 3d 142, 343 N.E.2d 165 (1976); *Miles Homes, Inc. v. Mintjal*, 17 Ill. App. 3d 642, 307 N.E.2d 724 (1974); *Pierce v. Yochum*, 330 N.E.2d 102 (Ind. App. 1975); *Keokuk State Bank v. Eckley*, 354 N.W.2d 785 (Iowa Ct. App. 1984); *Bailey v. Lilly*, 667 P.2d 933 (Mont. 1983); *Shervold v. Schmidt*, 359 N.W.2d 361 (N.D. 1984); *Soltis v. Liles*, 275 Or. 537, 551 P.2d 1297 (1976); *Stinemeyer v. Wesco Farms, Inc.*, 260 Or. 109, 487 P.2d 65 (1971); *Bradley v. Apel*, 531 S.W.2d 678 (Tex. Civ. App. 1975); *Williamson v. Wanlass*, 545 P.2d 1145 (Utah 1976); *Paul v. Kitt*, 544 P.2d 886 (Utah 1975); *Moeller v. Good Hope Farms*, 35 Wash. 2d 777, 215 P.2d 425 (1950).

feiture provision has been waived would be very likely if the value of the land subject to the forfeiture provisions substantially exceeded the amount still unpaid under the contract.³⁴

The waiver cases vary and are difficult to reconcile. In some cases rather innocuous forbearances by vendors have been translated into favorable holdings for vendees,³⁵ while in others quite substantial leniency has been unavailing.³⁶ In one Utah case,³⁷ for example, the vendees under an installment land contract for the purchase of a house made sporadic late payments for the first two years of the contract. Some monthly payments were missed entirely. The vendor repeatedly demanded that the contract be paid up to date, but from time to time the vendees were assured that no forfeiture was contemplated "at that time." Finally, more than two years from the date of the contract, the vendor declared a forfeiture and after unsuccessful negotiation brought an unlawful detainer action to have the vendee ousted and the contract forfeited. The trial court concluded that the vendor had waived the strict performance of the contract. The Utah Supreme Court reversed the trial court and upheld the forfeiture with the following language: "Under the circumstances of this case, we believe that the buyers . . . were given a reasonable length of time to clear themselves of default. . . . They had not paid the equivalent of the rental value of the property for the time they occupied it."³⁸

The quoted language is quite telling. Obviously, the amount of the payments in relation to the rental value has nothing at all to do with whether there was an effective waiver by the vendor. It is difficult not to conclude that the court was manipulating the waiver concept as a means of deciding whether, in terms of fairness and economic equity, the vendee should have another opportunity to make up his missed payments.³⁹ Such decision making may be salutary, but it should not be disguised.

34. Note, *Property—Forfeiture Provisions in Missouri Installment Land Contracts*, 29 Mo. L. Rev. 222, 226 (1964) (footnotes omitted).

35. See *supra* note 33 and accompanying text.

36. See, e.g., *Economy Sav. & Loan Co. v. Hollington*, 105 Ohio App. 243, 152 N.E.2d 125 (1957); *Christy v. Guild*, 101 Utah 313, 121 P.2d 401 (1942).

37. *Pacific Dev. Co. v. Stewart*, 13 Utah 403, 195 P.2d 748 (1948).

38. *Id.* at 409, 195 P.2d at 751.

39. The court may have been confusing the waiver concept with the principle of equitable relief from forfeiture. See *supra* note 11 and accompanying text.

B. Recognition of an Equity of Redemption

A number of jurisdictions have taken the view that the vendee, notwithstanding his default, should be granted a final opportunity to pay the balance owing on the contract or, in some instances, the arrearages, before losing his land. Some courts view this right, analogous to a mortgagor's equity of redemption, as unconditional, while others are inclined to recognize it only if the vendee's prior payments add up to a substantial investment or "equity" in the property. Sometimes the existence of the right turns on whether the vendee's payments significantly exceed the property's rental value or some similar test. Moreover, some cases require that the vendee not be guilty of gross negligence or bad faith. The critical point is that, unlike the cases discussed in the preceding paragraphs, these opinions do not rely upon a prior waiver by the vendor.

A typical case is *Nigh v. Hickman*,⁴⁰ decided by the Missouri Court of Appeals. In *Nigh* a vendee, under an installment land contract covering farmland, had paid almost thirty-five percent of the total purchase price. The vendee then defaulted on one payment by fifteen days, and the vendor refused to accept the late payment. The vendee sued for specific performance and tendered the balance owing on the contract. The appellate court held that the trial court correctly granted specific performance and that enforcing the forfeiture clause would have been inequitable. Although the contract contained no "time is of the essence" clause, the court indicated that the result would not have been different had such a clause been present.

A leading Hawaii Supreme Court decision, *Jenkins v. Wise*,⁴¹ adopts the foregoing specific performance approach in less ambivalent fashion. Prior to default, the vendees in *Jenkins* had paid sixteen percent of the total purchase price of \$100,000 under installment land contracts on two parcels of land. The vendees defaulted on two semiannual \$4,000 installment payments due in March and April, 1972. Pursuant to the contracts, the vendors notified the vendees in September of the same year that the contracts had been canceled. One month later, the vendees contracted to sell the property to third parties for a \$51,000 profit, and, accordingly, promised the vendors that the

40. 538 S.W.2d 936 (Mo. App. 1976); see also *Key v. Gregory*, 553 S.W.2d 329 (Mo. App. 1977); *Dill v. Zielke*, 26 Wash. 2d 246, 173 P.2d 977 (1946).

41. 58 Hawaii 592, 574 P.2d 1337 (1978).

original contracts soon would be paid in full. When payment was not made by December, the vendors sought a judicial declaration of cancellation of the contracts and the vendees counterclaimed for specific performance. The Hawaii Supreme Court reversed a trial court order canceling the contracts and, notwithstanding "time is of the essence" language contained therein, held in favor of vendees' claim for specific performance. According to the supreme court,

where the vendee's breach has not been due to gross negligence, or to deliberate or bad-faith conduct on his part, and the vendor can reasonably and adequately be compensated for his injury, courts in equity will generally grant relief against forfeiture and decree specific performance of the agreement. . . . [A] key factor in [a trial court's] determination is whether forfeiture would be harsh and unreasonable under the circumstances.⁴²

The court concluded that the vendees had acted in good faith even though they had contracted to resell after being notified of cancellation. Focusing on the fact that the vendees had incurred architectural and building permit expenses, the court stated that the vendees, "in good faith, were preparing to develop the property themselves, but in the words of [one of the vendees], the [contract to resell] was 'too good a deal.'"⁴³

The relationship between granting specific performance to a vendee and more traditional mortgage concepts is illustrated by the Florida District Court of Appeals' opinion in *H & L Land Co. v. Warner*.⁴⁴ The vendee in *Warner* had made installment payments for about five years, but during a four-year period of nonpayment the vendor remained silent as to the vendee's default. The vendee ultimately sued for specific performance, tendering the balance of the purchase price; the vendor counter-

42. *Id.* at 597, 574 P.2d at 1341.

43. *Id.* at 602, 574 P.2d at 1344. Jenkins was specifically reaffirmed by the Hawaii Supreme Court in *Kaiman Realty, Inc. v. Carmichael*, 65 Hawaii 637, 655 P.2d 872 (1982). In a supplemental opinion to *Kaiman Realty*, the Hawaii Supreme Court suggested that *Jenkins* is applicable only to installment land contracts and not to Hawaii's equivalent of earnest money contracts. See *Kaiman Realty, Inc. v. Carmichael*, ___ Hawaii ___, 659 P.2d 63 (1983). See also *K.M. Young Assoc., Inc. v. Cieslik*, 675 P.2d 793 (Hawaii Ct. App. 1983). For a clear-cut case of a denial of specific performance to a grossly negligent vendee, see *Curry v. Tucker*, 616 P.2d 8 (Alaska 1980).

44. 258 So. 2d 293 (Fla. Dist. Ct. App. 1972); see also *Huguley v. Hall*, 157 So. 2d 417 (Fla. 1963); *Mid-State Inv. Corp. v. O'Steen*, 133 So. 2d 455 (Fla. Dist. Ct. App. 1961), *cert. denied*, 136 So. 2d 349 (Fla. 1961).

claimed for removal of the contract as a cloud on the vendor's title. The court granted specific performance and stated:

[T]he vendor under a specifically enforceable installment land sale contract, who has received part of the purchase price and has given the vendee possession of the land and the benefits and burdens of ownership, is in essentially the same position as a vendor who has conveyed the legal title and taken back a purchase money mortgage⁴⁵

The court implicitly imposed at least three preconditions to specific performance: (1) the vendee must be in possession or have a right to possession, (2) the contract must be specifically enforceable, and (3) the vendee must assert and exercise his right of redemption by tendering full payment.⁴⁶

These conditions present problems, especially the last two. Arguably, tying these two requirements together is an inconsistent blending of contract and mortgage law. It is axiomatic that a vendee in default does not have a right to specific performance of a contract. Yet under mortgage law the right to redeem is not exercised until there has been a default. In *Warner* the second requirement was met because the court found that the vendor had waived the vendee's default. However, as has been pointed out,

By so holding, the court is going in circles. If one must tender the unpaid balance as a condition precedent to the vesting of the right of redemption, then one must exercise this right before one is entitled to it—an anomaly, to be sure. Thus, the rights of mortgagors will not be extended to purchasers in default who are either in straitened circumstances or unaware of the right of redemption—the very individuals whom the mortgage statutes were designed to protect.⁴⁷

Notwithstanding this apparent anomaly, more recent cases reinforce the argument that, in general, Florida installment land contracts will be treated as mortgages for redemption purposes. In *Hoffman v. Semet*⁴⁸ a Florida District Court of Appeals held that a vendee in default under an installment land contract had an equity of redemption and that the vendee's successor was entitled to satisfy the total outstanding indebtedness due the ven-

45. 258 So. 2d at 295.

46. See Comment, *supra* note 6, at 168-70.

47. *Id.* at 170.

48. 316 So. 2d 649 (Fla. Dist. Ct. App. 1975).

dor under the contract and to receive a conveyance of the real estate. The court cited *Warner* for the proposition that an installment land contract "must be deemed and held to be a mortgage, subject to the same rules of foreclosure and to the same regulations, restraints, and forms as are prescribed in relation to mortgages."⁴⁹ Unlike the situation in *Warner*, however, there had been no waiver of the default, and the contract was therefore not specifically enforceable within the implicit requirements of *Warner*. The *Semet* court did not deal with this difficulty. Instead, it simply repeated "equity of redemption" language in referring to the vendee's interest. Moreover, later appellate decisions,⁵⁰ while not involving a tardy vendee seeking to redeem, so pervasively assert that an installment land contract is a mortgage that it seems unlikely that a Florida vendee will be denied mortgage redemption rights.

The Kansas case of *Nelson v. Robinson*⁵¹ illustrates how a court can refuse to enforce a forfeiture provision and instead impose a remedy that treats the installment land contract as an equitable mortgage. The vendors in *Nelson* brought an action to cancel an installment land contract for the sale of farmland. The vendee was over \$1,900 delinquent in back payments, but had paid nearly one-third of the \$48,000 purchase price and had made valuable improvements to the land. The trial court refused to permit forfeiture, but rather ordered strict foreclosure of the contract. Under the terms of the decree, the vendee was given six months in which to pay the entire amount remaining due on the contract. Failure to pay within that period would result in forfeiture of the land and back payments to the vendor. If the vendee paid arrearages within ten days of the decree, however, the redemption period would be extended to eighteen months. Interestingly, the vendee, and not the vendor, appealed, and the Kansas Supreme Court affirmed the trial court's exercise of equitable discretion. It is noteworthy that the court here imposed the relatively rare mortgage remedy of strict foreclosure which

49. *Id.* at 651 (quoting *Midstate Inv. Corp. v. O'Steen*, 133 So. 2d 455 (Fla. Dist. Ct. App. 1961)).

50. See, e.g., *Ricard v. Equitable Life Assurance Soc'y*, 462 So. 2d 592 (Fla. Dist. Ct. App. 1985); *Parise v. Citizens Nat'l Bank*, 438 So. 2d 1020 (Fla. Dist. Ct. App. 1983); *Ernest v. Carter*, 368 So. 2d 428 (Fla. Dist. Ct. App. 1979); *Cook v. Merrifield*, 335 So. 2d 297 (Fla. Dist. Ct. App. 1976); *Torcise v. Perez*, 319 So. 2d 41 (Fla. Dist. Ct. App. 1975).

51. 184 Kan. 340, 336 P.2d 415 (1959).

was sought by neither party, but in which the vendor acquiesced.⁵²

The *Nelson* decision clearly does not mean that all installment land contracts in Kansas will be treated as mortgages. If, for example, the vendee's stake in the property had been substantially less, immediate forfeiture might have been ordered.⁵³ The case, however, illustrates that a Kansas vendor cannot rely on automatic enforcement of the forfeiture clause. Thus, in Kansas, courts may apply the law of mortgages to some installment contracts and contract law to others.

In California the movement toward recognition of a right of redemption for a defaulting vendee has received impetus from general statutory provisions, although the application of the statutes was uncertain until recently.⁵⁴ In *Barkis v. Scott*⁵⁵ the California Supreme Court reevaluated a long line of earlier precedents dealing with forfeiture. The court concluded that when a forfeiture would otherwise result, the vendee can be relieved therefrom under section 3275 of the Civil Code which provides that

Whenever, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his failure to comply with its provisions, he may be relieved therefrom, upon making full compensation to the other party, except in case of a grossly negligent, willful, or fraudulent breach of duty.⁵⁶

The vendor in *Barkis* sought to quiet title and enforce a forfeiture after the vendees inadvertently overdrew their bank account with their monthly house payment. The vendees' later efforts to pay were refused by the vendor. The court held that section 3275 should provide relief from forfeiture and that the vendees had established the right to keep the contract in force. Here the default was, at most, negligent and not "grossly negligent, willful, or fraudulent."

52. This mortgage remedy is apparently the standard method in Wisconsin for terminating a vendee interest. See *Exchange Corp. v. Kuntz*, 56 Wis. 2d 555, 202 N.W.2d 393 (1972).

53. For a discussion of the significance of the proportion paid, see *Croft v. Jensen*, 86 Utah 13, 40 P.2d 198 (1935).

54. See Comment, *Reforming the Vendor's Remedies for Breach of Installment Land Sale Contracts*, 47 S. CAL. L. REV. 191, 205 (1973).

55. 34 Cal. 2d 116, 208 P.2d 367 (1949).

56. CAL. CIV. CODE § 3275 (West 1970).

In *MacFadden v. Walker*⁵⁷ the California Supreme Court dealt with the “willful, but repentant defaulting vendee.” In *MacFadden* an elderly vendee had been in willful default over two years, but had paid over half of the purchase price. When the vendor sought to quiet title to the property, the vendee counterclaimed for specific performance, tendering the full amount due and owing on the contract. The court held that the policy against forfeitures required granting the right to specific performance even when the default is willful. The court reasoned that, when taken together, the prohibition against punitive damages contained in section 3294 of the Civil Code, the strict limitations on the right to provide for liquidated damages contained in sections 1670 and 1671, and the provision of section 3369 that “neither specific nor preventive relief can be granted to enforce a penalty or forfeiture in any case,” prevented a forfeiture that had no reasonable relation to the damage caused by the vendee’s breach even when that breach is willful. The court noted Professor Hetland’s “persuasive arguments” that installment land contracts should be treated like mortgages and deeds of trust and that willfully defaulting debtors should therefore have the right to redeem. However, it concluded that because the vendee was entitled to specific performance “we need not decide whether she might also be entitled to some other remedy under the law governing security transactions.”⁵⁸

The ultimate conclusion that a tardy vendee should be treated as a mortgagor for redemption purposes is still proving illusive for California courts. In *Kosloff v. Castle*⁵⁹ a vendor under an installment land contract covering the sale of a house for \$15,000 declared a forfeiture after the vendee had been in default on a final “balloon” payment of \$11,400 for approximately a year and a half. A few months later, the vendor filed an action in unlawful detainer and to quiet title. The trial court refused to permit the vendee to tender the contract balance and granted the vendor his requested relief. The District Court of Appeals affirmed the trial court determination. The court noted that *MacFadden* allowed specific performance to be granted to willfully defaulting vendees “in proper cases.” The *Kosloff* court

57. 5 Cal. 3d 809, 97 Cal. Rptr. 537, 488 P.2d 1353 (1971).

58. *Id.* at 816, 97 Cal. Rptr. at 541, 488 P.2d at 1357; *see also* *Williams Plumbing Co. v. Sinsley*, 53 Cal. App. 3d 1027, 126 Cal. Rptr. 345 (1975) (where breach was not intentional).

59. 115 Cal. App. 3d 369, 171 Cal. Rptr. 308 (1981).

emphasized that the vendee in *MacFadden* had paid over half of the purchase price prior to her default, whereas the *Kosloff* vendee had paid less than one-third of the price in the predefault period. Moreover, the *Kosloff* vendee had not only been willful, but also "grossly negligent," whereas the *MacFadden* default, while willful, was based on the vendee's belief that withholding payment was justified. Thus, the court found substantial evidence to sustain the trial court's weighing of the equities.

The *Kosloff* court also refused to hold that an installment land contract is a mortgage under Section 2924 of the Civil Code, which states in part that "every transfer of an interest in property, other than in trust, made only as a security for the performance of another act, is to be deemed a mortgage." Had the court so held, the vendee would have been afforded the redemption of a tardy mortgagor. Rather, the court stated, "any reform in this area is more appropriately initiated by the Legislature which is in a better position to effect and coordinate comprehensive answers to the many-faceted questions such a determination would evoke."⁶⁰

To vendors, the general trend toward recognizing an equity of redemption is rather frightening. In the absence of a statute, nothing but a court order can cut off an equity of redemption. In effect, this means that the vendor will be forced to litigate—precisely the thing he hoped to avoid by using the installment contract. Even if the court follows the example of the Supreme Court of Kansas, granting forfeiture in the event the purchaser is unable to redeem,⁶¹ the vendor's situation will be far less advantageous than he expected when the contract was signed.

C. Restitution

In a jurisdiction in which no equity of redemption is recognized, or in a case in which the vendee cannot or will not redeem, traditional analysis would suggest that forfeiture should follow. But in this area, too, the courts have been actively reforming the law. Increasingly, they are holding that forfeiture may not be "free" and that the vendor must return the pay-

60. *Id.* at 377, 171 Cal. Rptr. at 312; *see also* *Bartley v. Karas*, 150 Cal. App. 3d 366, 197 Cal. Rptr. 749 (1983) (vendee not entitled to reinstatement by payment of arrearages, but specific performance in vendee's favor appropriate where default not willful).

61. *See supra* notes 51-53 and accompanying text.

ments he has received insofar as they exceed his actual damages.⁶² Some courts, such as those of Utah, take this position only in cases in which they conclude that an outright forfeiture would be "unconscionable"⁶³ but "unconscionable" may simply mean that the vendee would suffer a substantial net loss if no restitution were ordered.⁶⁴

The Utah cases usually measure the vendor's damages as the fair rental value of the property during the period of the vendee's occupancy, plus such incidental damages as repairs and a sales commission upon resale.⁶⁵ In most situations presented, the court has concluded that these items exceed the vendee's payments and that he is not entitled to restitution.

For example, in *Strand v. Mayne*⁶⁶ the vendees under an installment land contract for the sale of a motel had made payments of principal and interest of over \$19,000 on a \$41,500 purchase price. They also had spent \$9,500 on repairs on the premises. Upon default, the vendors obtained possession by an unlawful detainer action. The vendees subsequently brought an action to recover the payments made under the contract on the ground that retention by the vendor was unconscionable. The Utah Supreme Court affirmed a summary judgment for the vendor, noting that the fair rental value of the motel up to the date of forfeiture, when added to the down payment the vendees had received on a resale of the property to a third party, exceeded the total of their payments to the vendors. The court observed that "[t]his clearly shows that the amount they have lost under the forfeiture provision is not unconscionable."⁶⁷

Similarly, in *Weyher v. Peterson*⁶⁸ the Utah court affirmed a judgment for a vendor under a forcible entry and detainer action

62. See, e.g., *Moran v. Holman*, 501 P.2d 769 (Alaska 1972); *Jenkins v. Wise*, 58 Hawaii 592, 574 P.2d 1337 (1978) (dictum); *K.M. Young & Assoc. v. Cieslik*, 675 P.2d 793 (Hawaii Ct. App. 1983); *Howard v. Bar Bell Land & Cattle Co.*, 81 Idaho 189, 340 P.2d 103 (1959); *Randall v. Riel*, 123 N.H. 757, 465 A.2d 505 (1983); *Morris v. Sykes*, 624 P.2d 681 (Utah 1981). Cf. *Stevensen v. Owen*, ____ Mont. ____, 687 P.2d 1010 (1984).

63. *Jacobson v. Swan*, 3 Utah 2d 59, 278 P.2d 294 (1954).

64. The Utah Court has had difficulty in reaching a consensus as to what is "unconscionable." See *Kay v. Wood*, 549 P.2d 709 (Utah 1976). See also *Erickson v. First Nat'l Bank*, ____ Mont. ____, 697 P.2d 1332 (1985) (vendee had paid \$154,751 while fair rental value was 114,750; court concluded the amount forfeited was not so large as to be unconscionable).

65. See, e.g., *Weyher v. Peterson*, 16 Utah 2d 278, 399 P.2d 438 (1965).

66. 14 Utah 2d 355, 384 P.2d 396 (1963).

67. *Id.* at 357, 384 P.2d at 398.

68. 16 Utah 2d 278, 399 P.2d 438 (1965).

based on a forfeiture clause. Finding that the rental value and damages, totaling \$10,505, exceeded the \$9,387 the vendee had paid on the contract, the court saw no inequity in refusing to allow the vendee to recover some of his payments.

Utah vendees also encountered difficulties with the restitution theory when the court focused on the contract land's market value rather than its rental value. In *Park Valley Corp. v. Bagley*⁶⁹ the trial court determined that vendees who had paid over \$139,000 on a \$1,080,000 installment land contract were entitled to almost half of that amount in restitution. After the vendees' breach, vendors resold the land for \$935,000, which was \$145,000 less than the contract price. In calculating the restitution amount, the trial court allowed the vendors only \$15,000 of the \$145,000 as damages for their loss of bargain. It did so on the theory that the contract price greatly exceeded the actual value of the land. The Utah Supreme Court reversed the trial court's decision and stressed that it was not unconscionable to hold vendees to an improvident bargain and that the vendors' damages should be based on the \$145,000 loss of bargain amount. Accordingly, since this amount exceeded the vendees' payments under the contract, the vendees were not entitled to any restitution.

Although vendees generally have not fared well in Utah litigation,⁷⁰ the reasoning of the above decisions indicates that complete vendor reliance on the forfeiture clause is probably misplaced. In the above cases the court upheld forfeiture because it believed the vendor's actual damages exceeded the vendee's payments. In the few Utah cases in which the vendee's payments exceeded the vendor's damages, the court approved of restitution of the excess to the vendee.⁷¹

Florida cases also appear to impose a burden of showing unconscionability upon a vendee who prays for restitution. Unfortunately, Florida courts have not been carefully analytic in articulating the relevant test and thus have made the availability of restitution quite unpredictable. In *Chace v. Johnson*,⁷² for exam-

69. 635 P.2d 65 (Utah 1981).

70. One reason for the poor results for Utah vendees is that few Utah vendees record their contracts. Those who do record and subsequently default can probably settle with their vendors for at least the nuisance value of the suit which would be necessary to clear the vendor's title, since the damages and restitution issues can always be litigated.

71. *Morris v. Sykes*, 624 P.2d 681 (Utah 1981); *Kay v. Wood*, 549 P.2d 709 (Utah 1976); *Jacobson v. Swan*, 3 Utah 2d 59, 278 P.2d 294 (1954).

72. 98 Fla. 118, 123 So. 519 (1929).

ple, the vendee was one year in default and sued to recover money totaling eighty percent of the contract price. The Florida Supreme Court ordered the vendor to return payments to the vendee that exceeded the vendor's damages. On the other hand, in *Sawyer v. Marco Island Development Corp.*,⁷³ a Florida appellate court held that a vendee's interest could be extinguished without return of the payments made. In that case, which involved title to thirty-six lots, a vendor brought suit to remove from the record the interests of several vendees. One of the vendees was one year in default and had paid ninety percent of the purchase price. None of the other vendees had paid over twenty-five percent of the purchase price and they were represented by a guardian ad litem because they did not appear. The vendee who had paid ninety percent of the purchase price, however, was personally represented. Despite the special circumstances of this last vendee, the court enforced forfeiture as to everyone, observing:

We see a substantial difference between the unjust enrichment which would result if a large deposit were forfeited within a short period of time and a situation where a vendor has removed his property from the market for several years while the vendee abandons the contract by ceasing to make further payments⁷⁴

The vendee's restitution remedy is perhaps best developed in California. It should be noted first that, under the rule of *Venable v. Harmon*⁷⁵ a California vendor cannot receive a deficiency judgment regardless of his loss. In addition, California ant forfeiture cases compel the vendor to return to the vendee any amount paid in excess of the vendor's damages. In *Freedman v. Rector of St. Mathias Parish*⁷⁶ the California Supreme Court held that it violated the public policies against forfeitures, penalties, and unjust enrichment to deny restitution, even to a vendee willfully in default.

However, determining the amount of restitution to which the vendee is entitled has caused problems. Under the reasoning

73. 301 So. 2d 820 (Fla. Dist. Ct. App. 1974), *cert. denied*, 312 So. 2d 757 (Fla. 1975).

74. 301 So. 2d at 821. There was a vigorous dissent with respect to the purchaser who had paid 90% of the price.

75. 233 Cal. App. 2d 297, 43 Cal. Rptr. 490 (1965) (based on Cal. Civ. Proc. Code § 580b (West 1970)).

76. 37 Cal. 2d 16, 230 P.2d 629 (1951).

of the California Supreme Court decision in *Honey v. Henry's Franchise Leasing Corp.*,⁷⁷ the vendor apparently has the option of measuring his damages by either the "rental value" (giving restitution of the amount by which the vendee's payments exceed the fair rental value of the property while the vendee was in possession) or the "difference value" (giving restitution of the amount by which the vendee's payments exceed the difference between the current market value and the higher original contract price).⁷⁸ Professor Hetland points out that "rarely over the past few decades has the value of the property dropped so that the vendor prefers difference value to his alternative measure—rental value."⁷⁹ The choice is the vendor's according to *Honey*, because permitting the vendee to make it would in effect give all installment vendees an option to convert their contracts into leases—an advantage the court hardly thought appropriate to give to a defaulter.

It is interesting to note that the economic results of the "difference value" measure of restitution are roughly similar to those of a judicial sale, in the sense that the market value of the property is debited against the vendor's claim. Of course, the two approaches are distinct, since in a restitution case the property's value is measured by the court upon the testimony of witnesses, rather than by a sale.⁸⁰

77. 264 Cal. 2d 801, 52 Cal. Rptr. 18, 415 P.2d 833 (1966).

78. The court noted that since rescission was not sought by the vendor, the rental value standard was inappropriate; the court consequently held that the proper calculation involved the difference value.

79. J. HETLAND, SECURED REAL ESTATE TRANSACTIONS 52 (1974).

80. If the California Supreme Court's formulation of the "difference value" measure of restitution is taken literally, then it seems subject to serious criticism. The problem with the measure is illustrated by the following example.

Assume *P* buys property from *V* under an installment contract with the following pertinent facts:

Purchase price	=	\$30,000
Down payment	=	2,000
Original debt	=	28,000, 8% interest, 25-year maturity
Monthly payments	=	216.11

Assume that default occurs after five years and that the value of the property has declined, so that:

Value of property	=	\$25,000.00
Balance on debt	=	25,836.58 (based on standard mortgage payment tables)

If foreclosure by judicial sale occurs, and if the costs of foreclosure are neglected and the sale brings fair market value, the sale proceeds will be \$25,000; *V* will be entitled to a deficiency judgment of \$836.58, assuming no antideficiency statute. (In California, no

D. Foreclosure as a Mortgage

The trend of the cases discussed above is clearly toward applying mortgage concepts to aid vendees that default in land in-

such judgment will be permitted if a one-to-four-family house is involved. CAL. CIV. PROC. CODE § 580b (West 1970).)

Suppose that *V*, instead of seeking foreclosure, elects to terminate *P*'s rights under the contract and to make restitution, as he is permitted to do under *Honey*. *V* must restore to *P* all payments made in excess of *V*'s loss. *V* elects the "difference value" measure of loss.

Payments made	=	\$14,966.60 (\$216.11 per month x 60 months)
		including \$2000 down payment
(-) <i>V</i> 's loss	=	5,000.00 (\$30,000 minus \$25,000)
Restitution	=	9,966.60

Thus, instead of being entitled to a deficiency judgment, *V* must pay back to *P* nearly \$10,000. This is, to say the least, a strange result.

The problem is that the court, in computing the amount of restitution, has ignored the "time value" of money. In a short-term marketing contract for \$30,000, if *P* breaches and *V* must remarket the property one month later for \$25,000, it is reasonably accurate to say that *V*'s damages are \$5,000. See *Jensen v. Dalton*, 9 Cal. App. 3d 654, 88 Cal. Rptr. 426 (1970). If, however, the period between contract and breach is five years (during which *V* has not had possession), the \$5,000 damage figure is completely erroneous. Let us recompute *V*'s damages, but in doing so translate all amounts involved to a single point in time by computing future values for each amount involved, using compound interest tables. We may select any point in time we wish, but a convenient reference point is the fifth anniversary of the sale—which happens to be the date of default. (This is convenient because nothing of financial significance happens thereafter, and whatever *V*'s damages are on that date can easily be translated to their value on the date of judgment simply by adding interest.)

In order to make translations of values to any given date, we must assume some interest or discount rate. Let us use eight percent, since it is the figure selected by the parties themselves when they initiated the transaction. Here is what actually happened:

Date	
1-1-0	<i>V</i> gives up \$30,000 asset, receives \$2,000 cash. Future value of \$28,000 as of 1-1-5 = \$41,715.66 (+)
2-1-0 through 1-1-5	<i>V</i> receives regular monthly payments of \$216.11. Future value of \$216.11 per month for 60 months = \$15,879.08 (-)
1-1-5	<i>V</i> receives back the property, worth \$25,000 = \$25,000.00 (-)
Subtracting what <i>V</i> received from what he gave up, damages = \$836.58	

Thus, the "difference value" approach to restitution, properly computed, yields results exactly equal to a foreclosure sale. Of course, under California law, *V* cannot actually recover the \$836.58 deficiency. *Venable v. Harmon*, 233 Cal. App. 2d 297, 43 Cal. Rptr. 490 (1965).

No California case appears clearly to recognize the foregoing problem. Perhaps the

installment contracts. Indeed, in recent years an increasing number of courts have accepted this view. The logical conclusion of this trend would be an absolute equivalency of installment contracts and mortgages, with foreclosure becoming the exclusive means by which a vendor could realize upon his security interest in the property. For a court to take this position should hardly seem surprising, for the judiciary reached the same conclusion long ago with regard to other forms of mortgage substitutes.⁸¹

California cases actually include no direct holding that foreclosure is a proper remedy in an installment contract default. However, a California Supreme Court decision, *Honey v. Henry's Franchise Leasing Corp.*,⁸² and an opinion by the Ninth Circuit Court of Appeals, *Ward v. Union Bond & Trust Co.*,⁸³ imply that a judicial sale would be appropriate if at least one of the parties requested it. To date there is no California appellate opinion in which either the vendee or the vendor sought a judicial sale, and thus the language in the cases mentioned must be regarded as dicta. Moreover, as our discussion of the *Kosloff* decision indicates,⁸⁴ not all California appellate courts are even willing to treat the installment land contract as a mortgage for equity of redemption purposes. Nevertheless, as a practical matter, it seems safe to assume that if the issue were presented to it, the California Supreme Court would conclude that vendee and vendor alike have the right to foreclosure of a defaulted installment land contract.

In Indiana the case for judicial sale is both better defined and less dependent on the wishes of the parties. In *Skendzel v. Marshall*⁸⁵ the vendor sought a judicial declaration of forfeiture

closest is *Kudokas v. Balkus*, 26 Cal. App. 3d 744, 103 Cal. Rptr. 318 (1972), a "difference value" case in which the court refused to allow the vendees to claim, as part of their "payments," the interest they had paid prior to default of deeds of trust they had assumed. *Id.* at 756, 103 Cal. Rptr. at 325. Even this holding does not address the problem systematically.

The "future value" problem is also raised in "rental value" restitution cases, but its impact is relatively slight if the vendee's payments have been fairly regular prior to default and if they approximate the rental value of the property.

81. See NELSON & WHITMAN, *supra* note 3, §§ 3.4—3.25.

82. 64 Cal. 2d 801, 52 Cal. Rptr. 18, 415 P.2d 833 (1966). One other decision by the California Supreme Court suggests the availability of foreclosure in the installment contract context. See *MacFadden v. Walker*, 5 Cal. 3d 809, 97 Cal. Rptr. 537, 488 P.2d 1353 (1971).

83. 243 F.2d 476 (9th Cir. 1957).

84. See *supra* notes 59-60 and accompanying text.

85. 261 Ind. 226, 301 N.E.2d 641 (1973), *cert. denied*, 415 U.S. 921 (1974), *appeal after remand*, 264 Ind. 77, 339 N.E.2d 57 (1975).

of a vendee's interest when the vendee had already paid \$21,000 of a \$36,000 contract price. The Indiana Supreme Court applied the concept that "equity abhors a forfeiture" and held that enforcement of the forfeiture clause was "clearly excessive" and "unreasonable." More significantly, however, the court treated the installment land contract as a mortgage:

The Court, in effect, views a conditional land contract as a sale with a security interest in the form of legal title reserved by the vendor. Conceptually, therefore, the retention of the title by the vendor is the same as reserving a lien or mortgage. Realistically, vendor-vendee should be viewed as mortgagee-mortgagor. To conceive of the relationship in different terms is to pay homage to form over substance.⁸⁶

The court ordered that the contract be foreclosed judicially according to Indiana mortgage procedure. While the court did not absolutely rule out forfeiture in all cases, it did limit application of forfeiture. Forfeiture is allowed only in cases of absconding or abandoning vendees or in situations in which the vendee has only paid a minimum amount and seeks to retain possession while the vendor is making expenditures for taxes, insurance, and maintenance.

Skendzel has been followed in several subsequent decisions by Indiana appellate courts. For example, in *Tidd v. Stauffer*⁸⁷ a defaulting vendee sought to obtain specific performance by paying the remaining balance when \$16,000 out of a \$39,000 contract price had been paid. The Court of Appeals of Indiana noted that forfeiture was inappropriate and directed the trial court to order judicial foreclosure of the contract in the event that the vendees failed promptly to pay the balance of the contract price. In *Fisel v. Yoder*⁸⁸ a vendee in default who had paid one-fourth of the purchase price was allowed to continue to make payments on the contract; the vendor's request for forfeiture was denied. On the other hand, in *Donaldson v. Sellmer*⁸⁹ the Court of Appeals of Indiana affirmed a trial court's award of forfeiture to a vendor when the vendee had paid \$7,000 out of a \$23,158 purchase price. In *Donaldson* the appellate court agreed that the case fell within an exception to *Skendzel* in that the

86. 261 Ind. at 234, 301 N.E.2d at 646.

87. 159 Ind. App. 570, 308 N.E.2d 415 (1974).

88. 162 Ind. App. 565, 320 N.E.2d 783 (1975).

89. 166 Ind. App. 60, 333 N.E.2d 862 (1975).

vendee "had wholly failed to perform his obligation to acquire adequate insurance and had allowed the property to deteriorate to such an extent that substantial repair was necessary before the house should even be habitable."⁹⁰ Similarly, a trial court's forfeiture decree was sustained when less than ten percent of the principal balance of \$275,000 had been paid and the vendees had failed to keep the property insured or pay real estate taxes.⁹¹

Thus in Indiana, installment land contracts are now treated as mortgages in most instances in which the defaulting vendee has a substantial equity. Because of the exceptions noted above, *Skendzel* does not go as far judicially as Oklahoma went legislatively in converting installment land contracts into mortgages. Nonetheless, the case is one of the clearest judicial statements to date of that principle.⁹²

The Indiana approach was adopted by an intermediate New York appellate court in *Bean v. Walker*.⁹³ In that case the tardy vendees had paid almost half of the original \$15,000 principal amount on an installment land contract for the sale of a house. Moreover, the vendees had substantially improved the property. The New York Supreme Court, Appellate Division, perceiving "no reason why [these] vendees should be treated any differently than the mortgagor at common law," reversed a trial court forfeiture decree and held that the "vendors may not summarily dispossess the vendees of their equitable ownership without first bringing an action to foreclose the vendees' equity of redemption."⁹⁴ The court, however, qualified its holding by specifically adopting the *Skendzel* limitations on the availability of the foreclosure remedy.

Perhaps the most straight-forward acceptance of the view

90. *Id.* at 66, 333 N.E.2d at 866. In *Goff v. Graham*, 159 Ind. App. 324, 306 N.E.2d 758 (1974), forfeiture of an installment land contract was upheld because evidence showed that the vendee had failed to insure as required by the contract, had committed waste, and had deliberately neglected the property. The vendee had paid a down payment of \$1,950 and one monthly payment of \$562.62 on a contract price of \$61,750 amortized over 20 years.

91. *Phillips v. Nay*, — Ind. App. —, 456 N.E.2d 745 (1983).

92. For analysis of the Indiana situation, see Bepko, *Contracts and Commercial Law*, 8 IND. L. REV. 116, 117-20 (1974); Polston, *Survey of Recent Developments in Indiana Law—Property*, 10 IND. L. REV. 297, 298 n.4 (1976); Strausbaugh, *Exorcising the Forfeiture Clause From Real Estate Conditional Sales Contracts*, 4 REAL EST. L. J. 71 (1975).

93. 95 A.D.2d 70, 464 N.Y.S.2d 895 (1983).

94. *Id.* at 74, 464 N.Y.S.2d at 898.

that the installment land contract should be deemed a mortgage for remedy purposes is *Sebastian v. Floyd*.⁹⁵ In *Floyd* the Kentucky Supreme Court reversed a trial court forfeiture determination where the defaulting vendee had paid \$4,300, or nearly forty percent of the principal balance, on an installment land contract for the sale of a house. The court noted a "modern trend . . . to treat land sale contracts as analogous to conventional mortgages, thus requiring a seller to seek a judicial sale of the property upon the buyer's default."⁹⁶ Accordingly the court was of the opinion that

[A] rule treating the seller's interest as a lien will best protect the interests of both buyer and seller. Ordinarily, the seller will receive the balance due on the contract, plus expenses, thus fulfilling the expectations he had when he agreed to sell his land. In addition, the buyer's equity in the property will be protected.⁹⁷

Although the court cited *Skendzel* with approval, its opinion contained none of the limitations on the foreclosure remedy suggested by the Indiana decision.⁹⁸

While conceptually muddled, the current Florida situation at a practical level seems relatively clear. While there appears to be no clear-cut holding of the Florida Supreme Court that installment land contracts must be treated as a mortgage or that a vendee has a right to insist on judicial foreclosure, Florida case law recognizes a tardy vendee's right to redemption or specific performance.⁹⁹ Not only do numerous Florida cases state in a variety of contexts that the installment land contract is a mortgage,¹⁰⁰ but vendors routinely seem to treat them as such by choosing to foreclose them as mortgages.¹⁰¹ Consequently, it

95. 585 S.W.2d 381 (Ky. 1979).

96. *Id.* at 383.

97. *Id.*

98. Recent Idaho judicial attempts to apply mortgage law concepts to installment land contract are perplexing. Compare *Ellis v. Butterfield*, 98 Idaho 644, 570 P.2d 1334 (1977) (affirming a trial court forfeiture decree) with *Thomas v. Klein*, 99 Idaho 105, 577 P.2d 1153 (1978) (reversing a trial court decree of forfeiture and ordering the trial court to conduct a judicial sale of the contract property). See also *McEnroe v. Morgan*, 106 Idaho 326, 678 P.2d 595 (Idaho Ct. App. 1984) (trial court determination that forfeiture was not unconscionable affirmed).

99. See *supra* notes 44-50 and accompanying text.

100. See cases cited *supra* note 50.

101. See, e.g., *Ricard v. Equitable Life Assurance Soc'y*, 462 So. 2d 592 (Fla. Dist. Ct. App. 1985) (recognizing right to deficiency judgment); *Ernest v. Carter* 368 So. 2d 428 (Fla. Dist. Ct. App. 1979); *Parise v. Citizens Nat'l Bank*, 438 So. 2d 1020 (Fla. Dist.

seems that Florida has joined the ranks of jurisdictions classifying installment land contracts as mortgages, at least for remedial purposes.

This movement will probably continue, especially in states in which there is little or no statutory regulation of land contracts. The same factors that induced the courts to treat other mortgage substitutes as mortgages—particularly the desperate borrower's willingness to sign anything presented to him and the potential for a harsh and unwarranted loss of his investment as a consequence of his default—should and almost certainly will be increasingly persuasive in the installment land contract context.

It is sometimes argued that this trend is undesirable and that it is socially advantageous for the law to provide an extremely quick and cheap method for a vendor to terminate the vendee's interest in real estate upon default. Such a procedure, it is said, encourages extension of credit to individuals whose credit-worthiness is so poor that they would otherwise be unable to transact. However, this argument has two errors. First, the cases discussed above illustrate that no vendor can count on forfeiture under a installment land contract as being either quick or cheap; indeed, it is an invitation to litigation. Second, no procedure, however quick or cheap, can be justified if it amounts to foul play.

The solution, of course, is not for the law to ignore the legitimate needs of installment land contract vendees, but to reform the modes of foreclosure commonly used for mortgages to make them as inexpensive and rapid as feasible, consistent with the requirement of fairness and due process. If this is done, installment land contracts—if they continue to exist at all—can be brought within the ambit of the more efficient mortgage foreclosure proceedings, and no one will have cause to complain. Perhaps the growing tendency of courts to treat land contracts as mortgages will bring pressure on state legislatures to accomplish needed reform of mortgage law.

In light of the judicial trend outlined above, we must ask why installment land contracts continue to be used. The question is particularly perplexing in those states in which relatively rapid nonjudicial foreclosure is available for mortgages or deeds of trust. The reason given several years ago by Professor Warren

Ct. App. 1983).

may still apply: "[T]he vendor continues to use the installment sale contract despite its deficiencies with regard to remedies because he is willing to gamble that the vendee's rights under this device will never be asserted and his own contractual advantages will not be challenged."¹⁰² In addition, it is possible that most vendors and real estate brokers do not accurately perceive the risks of litigation that land contracts present. Whatever the motivations of vendors, it is clear that the risks are inflating rapidly.

V. CONSTITUTIONALITY OF FORFEITURE

In recent years power of sale mortgage and deed of trust foreclosure procedures have been increasingly attacked as violating the due process clause of the fourteenth amendment. The constitutional questions presented by these attacks may be raised as well in the context of installment land contracts. Attacks on foreclosure procedures have focused on two aspects of the process: notice and hearing.¹⁰³ Many power of sale statutes do not provide for any notice, or only notice by publication or posting, to the debtor and junior lienors.¹⁰⁴ In addition, the statutes usually make no provision at all for a hearing, either before or after foreclosure. If the due process clause applies to the foreclosure process, many statutes clearly violate the standard articulated by the Supreme Court in *Mullane v. Central Hanover Bank & Trust Co.*,¹⁰⁵ since the notice they provide is "not reasonably calculated to reach those who could easily be informed by other means at hand."¹⁰⁶ The hearing standard is not quite so

102. Warren, *California Installment Land Sales Contracts: A Time for Reform*, 9 UCLA L. REV. 608, 633 (1962).

103. See NELSON & WHITMAN, *supra* note 3, §§ 7.19-7.30; see also Leen, Galbraith & Gant, *Due Process and Deeds of Trust—Strange Bedfellows?*, 48 WASH. L. REV. 763 (1973); Nelson, *Deed of Trust Foreclosure Under Powers of Sale*, 28 J. MO. B. 428 (1972); Pedowitz, *Current Developments in Summary Foreclosure*, 9 REAL PROP. PROB. & TR. J. 421, 425-31 (1974); Comment, *The Constitutionality of the California Trustee's Sale*, 61 CALIF. L. REV. 1282 (1973); Comment, *Due Process Problems of Mississippi Power of Sale Foreclosure*, 47 MISS. L.J. 67 (1976); Comment, *Notice Requirements of the Non-judicial Foreclosure Sale*, 51 N.C. L. REV. 1110 (1973); Comment, *Power of Sale Foreclosure After Fuentes*, 40 U. CHI. L. REV. 206, 220 (1972).

104. See, e.g., D.C. CODE ANN. § 45-715 (1981); MISS. CODE ANN. § 89-1-55 (1972); cf. MINN. STAT. ANN. § 580.03 (West 1947) (personal service on person in possession only).

105. 339 U.S. 306 (1950).

106. *Id.* at 319. This conclusion has been reached in three mortgage foreclosure cases. See *Ricker v. United States*, 417 F. Supp. 133 (D. Me. 1976); *Turner v. Blackburn*, 389 F. Supp. 1250 (W.D.N.C. 1975); *Law v. United States Dep't of Agriculture*, 366 F.

clear, but there is a strong possibility that the total absence of a presale hearing would also be held unconstitutional.¹⁰⁷

While application of these due process standards to installment land contract forfeitures is somewhat uncertain, several observations are appropriate. Many contract forms do provide for direct mail notice to the vendee as a prerequisite to forfeiture, and this would certainly meet the *Mullane* standard;¹⁰⁸ however, as in the case of mortgages, a contract procedure that provides only publication notice or the like would not.

The hearing issue is more difficult. Installment land contracts themselves almost never provide for a hearing. Moreover, state statutory termination procedures rarely require a pretermination hearing, and those that do may still be constitutionally deficient. For example, the Minnesota statute specifically authorizes a trial court to issue, prior to contract termination, temporary injunctive relief at the vendee's request against further termination proceedings.¹⁰⁹ The vendee may plead affirmatively "any matter that would constitute a defense to an action to terminate the contract."¹¹⁰ If the constitutional hearing requirement is satisfied by legislation that authorizes the vendee to request a hearing, then the foregoing statute meets such a standard. On the other hand, the statute may still be constitutionally suspect if the hearing must be triggered automatically by the contract termination itself.¹¹¹

Whether it will ever be necessary for the contract forfeiture process to withstand scrutiny on the merits of the due process

Supp. 1233 (N.D. Ga. 1973). *Contra* Federal Deposit Ins. Corp. v. Morrison, 747 F.2d 610 (11th Cir. 1984). See also *Mennonite Board of Missions v. Adams*, 103 S. Ct. 2706 (1983) (notice by publication and posting fails to provide mortgagee with minimum notice required by the fourteenth amendment in a proceeding to sell mortgaged real estate for nonpayment of taxes).

107. See *United States v. White*, 429 F. Supp. 1245 (N.D. Miss. 1977); *Ricker v. United States*, 417 F. Supp. 133 (D. Me. 1976); *Turner v. Blackburn*, 389 F. Supp. 1250 (W.D.N.C. 1975); *Garner v. Tri-State Dev. Co.*, 382 F. Supp. 377 (E.D. Mich. 1974); *Northrip v. Federal Nat'l Mortgage Ass'n*, 372 F. Supp. 594 (E.D. Mich. 1974); *rev'd on other grounds*, 527 F.2d 23 (6th Cir. 1975). But see *Guidarelli v. Lazaretti*, 305 Minn. 551, 233 N.W.2d 890 (1975).

108. Junior liens may, of course, be created by contract vendees. For example, a vendee may mortgage his contract interest. If such an interest exists and is recorded or otherwise readily identifiable by the vendor, failure of the vendor to provide notice to the junior lienor may raise the same due process issues as in the analogous first mortgage foreclosure situation. See *Mennonite Board of Missions v. Adams*, 103 S. Ct. 2706 (1983).

109. MINN. STAT. ANN. § 559.211 (West Supp. 1985).

110. *Id.*

111. See NELSON & WHITMAN, *supra* note 3, § 7.25.

clause is questionable. Two defenses raised, often successfully, by power of sale mortgagees appear to similarly apply to the installment land contract situation. The first is waiver. If the contract itself contains language by which the vendee authorizes a forfeiture action by the vendor without notice or hearing, can the vendee later be heard to complain that his constitutional rights were violated? In related contexts, the Supreme Court has held that the efficacy of such a contractual waiver depends on a variety of factors, including the specificity of the waiver, the relative equality of bargaining power of the parties, the sophistication of the waiving party and perhaps whether the waiver was part of a printed contract.¹¹² Obviously each case must be litigated upon its facts but in the typical installment land contract transaction the waiver is probably not very explicit, is part of the printed form, and is generally not a point of negotiation. Consequently, often the vendee will be able to make a colorable argument that the purported waiver does not bind him.

The second defense that power of sale mortgagees have asserted in constitutional litigation is that no state action is involved in such foreclosures. State action is, of course, a prerequisite to applicability of the fourteenth amendment; if non-judicial foreclosure is deemed a purely private process, no federal due process standard need be met. The plaintiffs in these cases have sought to show the presence of state action, pointing out that in most states in which power of sale foreclosure is widely employed it is authorized and regulated by statute. A few early cases found state action to be present,¹¹³ but the clear trend of recent decisions is against such a finding.¹¹⁴ No Supreme Court

112. *Fuentes v. Shevin*, 407 U.S. 67 (1972); *Swarb v. Lennox*, 405 U.S. 191 (1972); *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174 (1972). Mortgage foreclosure cases rejecting the mortgagee's waiver argument include *Rau v. Cavanaugh*, 500 F. Supp. 204 (D.S.D. 1980); *Ricker v. United States*, 417 F. Supp. 133 (D. Me. 1976); *Turner v. Blackburn*, 389 F. Supp. 1250 (W.D.N.C. 1975); *Garner v. Tri-State Dev. Co.*, 382 F. Supp. 377 (E.D. Mich. 1974); *Law v. United States Dep't of Agriculture*, 366 F. Supp. 1233 (N.D. Ga. 1973); cf. *Huggins v. Dement*, 13 N.C. App. 673, 187 S.E.2d 412 (provision in deed for foreclosure upon default found to constitute sufficient notice for due process requirements), *appeal dismissed*, 281 N.C. 314, 188 S.E.2d 898, *cert. denied*, 409 U.S. 1071 (1972); see Comment, *Notice Requirements of the Non-judicial Foreclosure Sale*, 51 N.C. L. Rev. 1110 (1973).

113. See *Turner v. Blackburn*, 389 F. Supp. 1250 (W.D.N.C. 1975); *Northrip v. Federal Nat'l Mortgage Ass'n*, 372 F. Supp. 594 (E.D. Mich. 1974), *rev'd on other grounds*, 527 F.2d 23 (6th Cir. 1975). *Turner* relies heavily upon the rather peculiar participation of the clerk of the court in nonjudicial foreclosures under the then-applicable North Carolina statute.

114. See *Northrip v. Federal Nat'l Mortgage Ass'n*, 527 F.2d 23 (6th Cir. 1975); Bar-

decision has yet been rendered on the point, but the Supreme Court will probably find that state action is absent in the typical power of sale mortgage foreclosure.

While few state action cases exist in the installment land contract termination setting,¹¹⁵ one federal decision is instructive. In *Staley Farms, Inc. v. Rueter*¹¹⁶ a contract vendee challenged the constitutionality of the Iowa statutory forfeiture procedure on the ground that it failed to provide a hearing prior to forfeiture. The vendee argued that state action was present because the statute "encouraged" deprivation of constitutional rights and delegated a traditionally public function to private parties. The United States Court of Appeals for the Eighth Circuit rejected both arguments and affirmed the trial court's determination that state action did not exist. According to the Eighth Circuit, the encouragement theory lacked merit because the Iowa statute did not compel the vendor to use it. Likewise, the public function concept did not apply because the statute was not the exclusive method of resolving such contract disputes. Finally, the court noted that "there is no overt official involvement required through [the Iowa statute]."¹¹⁷

The *Staley Farms* result and reasoning have obvious implications for nonstatutory forfeiture as well. While states through their court systems and case law superintend forfeitures generally, they surely are no less involved in the statutory termination setting. Thus, if state action is absent when state legislation specifically authorizes a contract forfeiture proceeding, it seems even more clearly absent when such contracts and their remedies are regulated exclusively by case law.

VI. THE DEED IN ESCROW AS AN AID TO VENDOR FORFEITURE REMEDY

Vendors frequently attempt to avoid pro-vendee case law and obviate title problems incident to vendee recording of in-

rera v. Security Bldg. & Inv. Corp., 519 F.2d 1166 (5th Cir. 1975); *Bryant v. Jefferson Fed. Sav. & Loan Ass'n*, 509 F.2d 511 (D.C. Cir. 1974); *Y Aleman Corp. v. Chase Manhattan Bank*, 414 F. Supp. 93 (D. Guam 1975); *Kenly v. Miracle Properties*, 412 F. Supp. 1072 (D. Ariz. 1976); *Lawson v. Smith*, 402 F. Supp. 851 (N.D. Cal. 1975); *Global Indus., Inc. v. Harris*, 376 F. Supp. 1379 (N.D. Ga. 1974); *Federal Nat'l Mortgage Ass'n v. Howlett*, 521 S.W.2d 428 (Mo.), *appeal dismissed*, 423 U.S. 909 (1975).

115. See *Aldape v. Lubke*, 107 Idaho 316, 688 P.2d 1221 (1984); *Staley Farms, Inc. v. Rueter*, 662 F.2d 520 (8th Cir. 1981); *Jensen v. Schreck* 275 N.W.2d 374 (Iowa 1979).

116. 662 F.2d 520 (8th Cir. 1981).

117. *Id.* at 522.

installment land contracts by utilizing a deed in escrow arrangement. Under this procedure the vendee is typically required at the time of execution of an installment land contract to deliver to an escrow agent an executed quitclaim deed to the real estate. If the vendee defaults, the vendor notifies the escrow agent, who is authorized by the escrow agreement to record the deed.¹¹⁸ Ideally, from the vendor's perspective the recording of a quitclaim deed not only terminates the vendee's interest, but also clears up any title cloud created by the earlier vendee recording the contract.

The advantages of the foregoing procedure to the vendor may be more apparent than real. If a mortgagor executes and delivers a deed conveying the mortgaged real estate to the mortgagee in a regular mortgage transaction, the deed will be deemed a clog on the mortgagor's equity of redemption and hence invalid and unenforceable.¹¹⁹ The clogging doctrine may be as readily applied when the financing device is an installment land contract rather than a mortgage. To the extent a jurisdiction treats a contract for deed as a mortgage and the vendee as owning an equity of redemption, it may simply characterize the vendee's contemporaneous quitclaim deed as an invalid attempt to clog the vendee-mortgagor's equity of redemption. This escrow arrangement frequently succeeds, not due to its inherent substantive soundness but because defaulting vendees fail to assert their rights and many title examiners for subsequent purchasers from the vendor simply do not fully appreciate the implications of the anticlogging doctrine in this context.

VII. OTHER REMEDIES FOR VENDORS

If installment land contracts were governed exclusively by mortgage law, the vendor's remedies in the event of vendee default would be both clearly defined and relatively simple. The vendor could choose to foreclose the contract and, if less than the contract price is obtained at the foreclosure sale and antideficiency legislation¹²⁰ is not a problem, seek a deficiency judgment against the vendee for the difference. Alternatively, if

118. See, e.g., *In re Mancha*, 35 Bankr. 427 (9th Cir. 1983); *McEnroe v. Morgan*, 106 Idaho 326, 678 P.2d 595 (Idaho Ct. App. 1984).

119. See *NELSON & WHITMAN*, *supra* note 3, § 3.1.

120. See *id.* §§ 8.1-8.3; *Ricard v. Equitable Life Assurance Soc'y*, 462 So. 2d 592 (Fla. Dist. Ct. App. 1985).

the contract imposed personal liability for the contract amount on the vendee, the vendor could sue on the contract debt and attempt to collect any judgment obtained from the vendee's other assets, including the contract land.

Unfortunately, in few, if any, jurisdictions will the vendor's remedies be that clear. In some jurisdictions the installment land contract is still largely regarded as a contract and, as such, is governed primarily by contract principles.¹²¹ In others, courts apply an often confusing amalgam of contract and mortgage law.¹²² This "split personality" often exists even in those states that have taken the greatest strides¹²³ in treating the installment land contract as a mortgage because the courts in those jurisdictions have yet to confront the myriad issues and implications that the mortgage characterization ultimately creates.

Whatever the conceptual basis, vendors may well have a variety of nonforfeiture remedies against a defaulting vendee. While such remedies have traditionally received little attention because of pervasive emphasis on the forfeiture remedy, as the latter remedy becomes less reliable, alternatives will receive more attention. The following material explores the analytical underpinnings of these remedies and practical considerations incident to their use.

A. *Specific Performance for the Price*

Under the specific performance for the price remedy, the vendor chooses to treat the installment land contract like an earnest money contract. The vendor tenders title to the land and seeks an order requiring the vendee to pay the remainder of the contract purchase price. While many courts will grant specific performance to the vendor under such circumstances,¹²⁴ a few, like the minority of courts in the earnest money contract con-

121. See, e.g., *First Nat'l Bank v. Cape*, 100 N.M. 525, 673 P.2d 502 (1983); *Nygaard v. Anderson*, 229 Or. 323, 366 P.2d 899 (1961); *Park Valley Corp. v. Bagley*, 635 P.2d 65 (Utah 1981); *Stonebraker v. Zinn*, 286 S.E.2d 911 (W. Va. 1982).

122. Compare *Ellis v. Butterfield*, 98 Idaho 644, 570 P.2d 1334 (1977) with *Thomas v. Klein*, 99 Idaho 105, 577 P.2d 1153 (1978).

123. See *supra* notes 81-101 and accompanying text.

124. See, e.g., *SAS Partnership v. Schafer*, ___ Mont. ___, 653 P.2d 834 (1982); *Glacier Campground v. Wild Rivers, Inc.*, 182 Mont. 389, 597 P.2d 689 (1979); *Renard v. Allen*, 237 Or. 406, 391 P.2d 777 (1964).

text,¹²⁵ require the vendor to show that the remedy at law is inadequate.¹²⁶

However, the specific performance remedy is conceptually more problematic in the installment land contract setting than in the earnest money contract situation. An earnest money contract typically contemplates payment of the balance of the contract price on one closing date. In contrast, the installment land contract, as a financing device, is paid in installments over a long period of time. If an earnest money vendee defaults on the closing date, a suit for the full contract price seems conceptually uncomplicated. On the other hand, when an installment land contract vendee defaults, it is more difficult to envisage a suit for more than the installments actually in default. Consequently, a vendee could argue that a condition precedent to specific performance for the balance of the contract price should be an acceleration clause allowing the vendor to declare the entire contract amount due and payable upon vendee breach. In the absence of such a clause, the vendor conceivably could be left with the undesirable option of suing only for the past due installments plus interest. In any event, it is prudent for the vendor to include an acceleration clause in installment land contracts.

When specific performance is available, a vendor normally would use it when the vendee has assets to satisfy a judgment for the price and the land is worth less than the contract price. In this relatively rare situation, the forfeiture remedy should be avoided because the election of remedies rule may prevent any further relief against the vendee. Specific performance, on the other hand, would entail a judgment for the full price which would be collectible by judicial sale of any or all of the vendee's assets, including the contract real estate.¹²⁷

B. Foreclosure by Sale of the Vendee's Rights

When permitted, foreclosure by sale of the vendee's rights allows the vendor to treat the installment land contract as a mortgage and results in a judicial sale of the land. If the sale

125. See *Centex Homes Corp. v. Boag*, 128 N.J. Super. 385, 320 A.2d 194 (1974); *Suchan v. Rutherford*, 90 Idaho 288, 410 P.2d 434 (1966).

126. See, e.g., *Williamson v. Magnusson*, 336 N.W.2d 353 (N.D., 1983).

127. See *Glacier Campground v. Wild Rivers, Inc.* 182 Mont. 389, 597 P.2d 689 (1979).

brings more than the contract price, the surplus will go to the vendee. If the sale yields less than the contract amount, a deficiency judgment against the vendee often is available. In states that have opted to equate the installment land contract with the mortgage, the vendor may be required to pursue the foreclosure remedy.¹²⁸ In states in which the mortgage status of the installment land contract is less clear, courts are often willing to allow the vendor to utilize the foreclosure remedy.¹²⁹ In still other jurisdictions, however, the vendor's ability to choose the foreclosure remedy seems more doubtful in that the vendor would be seeking a mortgage remedy under a device governed by contract law. In such situations it is advisable to include in the installment land contract itself language specifically affording the vendor the foreclosure option.

C. *Strict Foreclosure*

A number of states, including some with no tradition of foreclosing installment contracts by sale, will award strict foreclosure¹³⁰ to a vendor in an installment land contract.¹³¹ The effect of this remedy is much like a judicial declaration of forfeiture: the contract is canceled and the vendor's title to the land is confirmed.¹³² However, it differs from forfeiture in that the court will fix a redemption period within which the vendee and assignees¹³³ of the vendee's interest may specifically enforce the con-

128. See *supra* notes 81-101 and accompanying text.

129. See, e.g., *Ulander v. Allen*, 37 Colo. App. 279, 544 P.2d 1001 (1976); *Mustard v. Sugar Valley Lakes*, 7 Kan. App. 2d 340, 642 P.2d 111 (1981); *Ryan v. Kolterman*, 215 Neb. 355, 338 N.W.2d 747 (1983); *Lamont v. Evjen*, 29 Utah 2d 266, 508 P.2d 532 (1973). See generally Annot., 77 A.L.R. 270 (1932).

130. For a more extended discussion of strict foreclosure in the mortgage context, see NELSON & WHITMAN, *supra* note 3, §§ 7.9-7.10.

131. See, e.g., *Canterbury Court, Inc. v. Rosenberg*, 224 Kan. 493, 582 P.2d 261 (1978); *Ryan v. Kolterman*, 215 Neb. 355, 338 N.W.2d 747 (1983); *Swaggart v. McLean*, 38 Or. App. 207, 589 P.2d 1170 (1979); *Kallenbach v. Lake Publications, Inc.*, 30 Wis. 2d 647, 142 N.W.2d 212 (1966). See generally Randolph, *Updating the Oregon Installment Land Contract*, 15 WILLAMETTE L.J. 181, 211-13 (1979); Vanneman, *Strict Foreclosure of Land Contracts*, 14 MINN. L. REV. 342 (1930); Annot., *supra* note 129. Some courts routinely give strict foreclosure without calling it such; they simply award a "grace period" for the purchaser to pay the contract, and declare a forfeiture if he or she does not do so. See *Jesz v. Geigle*, 319 N.W.2d 481 (N.D. 1982); *Moeller v. Good Hope Farms, Inc.*, 35 Wash. 2d 777, 215 P.2d 425 (1950) (grace period discretionary).

132. Some cases explicitly treat forfeiture and strict foreclosure as alternatives available to the vendor. See *Walker v. Nunnenkamp*, 84 Idaho 485, 373 P.2d 559 (1962); *Zumstein v. Stockton*, 199 Or. 633, 264 P.2d 455 (1953).

133. See, e.g., *Westfair Corp. v. Kuelz*, 90 Wis. 2d 631, 280 N.W.2d 364 (Wis. Ct.

tract by tendering the balance due.¹³⁴ The contract will be canceled only if the vendee or his assignees do not tender the balance due. Because strict foreclosure, like forfeiture, deprives the vendee of any "equity" he or she may have accumulated in the property, some courts will award it only upon a showing that the land has no value in excess of the contract balance.¹³⁵ If there is excess value, some courts will decree a judicial sale instead.¹³⁶

D. Suit for Damages

Another remedy arguably available to the vendor is an action for damages.¹³⁷ The vendor's damages will probably be measured by the difference between the contract price and the fair market value of the land as of the date of the vendee's breach, the standard normally applied in earnest money contract settings.¹³⁸ Pursuit of this remedy, however, is only possible when the vendee has abandoned the land. When the forfeiture remedy is necessary to regain the land, the damages action will probably be barred by the election of remedies doctrine. Moreover, the vendor faces the unenviable prospect of having to convince a court or jury that the land was worth less on the date of the breach than the contract price. Obviously, if the vendee has assets to satisfy a judgment, the vendor would be better off to sue for specific performance for the price or to seek to foreclose the contract as a mortgage. If the foreclosure sale yields less than

App. 1979) (assignee of mechanics' lienor against vendee has right to redeem in strict foreclosure proceeding).

134. A further distinction exists. If the vendor declares a forfeiture, and subsequently demands or accepts payments on the contract, the court may treat his behavior as inconsistent with the forfeiture and hence as waiving it. On the other hand, acceptance of payments is entirely consistent with a vendor's demand for strict foreclosure, since until the end of the redemption period fixed by the court, the purchaser has every right to attempt to pay off the contract. See *Heisel v. Cunningham*, 94 Idaho 461, 491 P.2d 178 (1971).

135. *Ryan v. Kolterman*, 215 Neb. 355, 338 N.W.2d 747 (1983); *State Sec. Co. v. Daringer*, 206 Neb. 427, 293 N.W.2d 102 (1980).

136. *Walker v. Nunnenkamp*, 84 Idaho 485, 373 P.2d 559 (1962); *Blondell v. Beam*, 243 Or. 293, 413 P.2d 397 (1966).

137. See *Nemec v. Rollo*, 114 Ariz. 589, 562 P.2d 1087 (Ariz. Ct. App. 1977).

138. See R. CUNNINGHAM, W. STOEBOCK & D. WHITMAN, *PROPERTY* § 10.3 (1984). Note that the time value of money must be taken into account in order to avoid unfair results in computing damages. See *supra* note 80.

the contract price, the vendor can usually obtain a deficiency judgment.¹³⁹

E. Election of Remedies Problem

To the extent that a jurisdiction recognizes forfeiture as a valid remedy, a vendor faces an election of remedies problem. Once forfeiture has been accomplished, the vendor typically is barred from seeking to recover the equivalent of a mortgage deficiency judgment.¹⁴⁰ Suppose, for example, that under an installment land contract the total purchase price was \$50,000, of which the vendee paid \$5,000 in cash at the date of contract execution and agreed to pay the balance in nine equal annual installments of \$5,000, together with accrued interest at twelve percent per annum. Suppose further that the vendee never makes a further payment on the contract and that the vendor chooses to invoke forfeiture. Later the vendor discovers that the land is worth only \$30,000. Under the election of remedies doctrine the vendor cannot collect from the vendee the difference between the balance due on the contract (\$45,000) and the fair market value of the land. Moreover, the same result will be reached even when the contract obligation to the vendor is evidenced by a separate promissory note.¹⁴¹ Occasionally a state will reject the election of remedies doctrine but reach the same result on the ground that it "flows from the fact that the contract between the parties has been terminated, thereby extinguishing any right to recover the unpaid purchase price."¹⁴²

Some state statutes ameliorate the vendor's election of remedies problem by authorizing, in certain limited circumstances, an award of damages to the vendor even though a contract termination election has already been made. For example, the Ohio termination statute provides that even though a judgment for cancellation of the contract has taken place, a damage award may be entered against the vendee if the latter "has paid an amount less than the fair rental value plus deterioration or de-

139. See *Ricard v. Equitable Life Assurance Soc'y*, 462 So. 2d 592 (Fla. Dist. Ct. App. 1985); *Glacier Campground v. Wild Rivers, Inc.* 182 Mont. 389, 597 P.2d 689 (1979).

140. See *Zirinsky v. Sheehan*, 413 F.2d 481 (8th Cir. 1969); *Nemec v. Rollo*, 114 Ariz. 589, 562 P.2d 1087 (Ariz. Ct. App. 1977); *Langenes v. Bullinger*, 328 N.W.2d 241 (N.D. 1982); *Butler v. Michel*, 14 Ohio App. 3d 116, 470 N.E.2d 217 (1984); *Trans West Co. v. Teuscher*, 27 Wash. App. 404, 618 P.2d 1023 (1980).

141. See *Nemec v. Rollo*, 114 Ariz. 589, 562 P.2d 1087 (Ariz. Ct. App. 1977).

142. *Gray v. Bowers*, 332 N.W.2d 323, 325 (Iowa 1983).

struction of the property occasioned by the vendee's use."¹⁴³ In addition, a court may ameliorate the harshness of the election of remedies rule by its determination of when the election took place. For example, the Michigan Supreme Court has held that "while the [vendor] may not accept or take possession and still seek money damages, he may, even after sending notice of forfeiture, refuse tender of possession and either commence an action for money damages or for foreclosure of the land contract."¹⁴⁴

VIII. TITLE PROBLEMS FOR VENDEES

When a person purchases property under an installment land contract, the chances of title problems with respect to the vendee's interest are greater than if the transaction were cast as a purchase money mortgage. Even in those jurisdictions that have reduced the impact of the forfeiture provision by statute or judicial decision, a vendee may still have problems with his or her title.

In the usual purchase money mortgage situation, the purchaser will likely examine the seller's title and require that it be marketable. Even if the purchaser is not sophisticated enough to have the title checked, any third party lender involved in the transaction will insist upon a title insurance policy or at least upon an attorney's title opinion as evidence that the seller's title is good. On the other hand, in installment land contract situations the vendor's title will likely not be examined at the time the contract is executed. There usually is no third party lender to insist upon title examination—the vendor serves that economic function—and the vendor is not likely to insist that his own title be examined. Moreover, many installment land contract vendees have low incomes and either cannot afford a title examination or do not recognize the need for it. Accordingly, many vendees may unknowingly execute the contract, take possession, and make substantial installment payments when in fact the vendor's title is encumbered by mortgages, judgment liens,

143. OHIO REV. CODE ANN. § 5313.10 (Page 1981). For an interpretation of this provision, see *Marvin v. Stemen*, 68 Ohio App. 2d 26, 426 N.E.2d 205 (1980); see also *Durham*, *supra* note 30.

144. *Gruskin v. Fisher*, 405 Mich. 51, 57-58, 273 N.W.2d 893, 896 (1979). Moreover, at least one court has rejected the election rule entirely in the installment land contract context and has substituted for it an estoppel concept. See *Keesee v. Fetzek*, 106 Idaho 507, 681 P.2d 600 (Ida. App. 1984).

or other interests perfected prior to the execution of the contract.¹⁴⁵

The recording act can also cause substantial problems for an installment land contract vendee. In the usual purchase money mortgage transaction, the deed to the mortgagor and the mortgage or deed of trust will be recorded almost immediately. If there is no third party lender, the purchaser will record his deed as a matter of custom. Any third party lender involved will insist upon and carry out immediate recordation in order to protect itself against subsequent interests and encumbrances that may be created by or rise against the mortgagor. This recording by the mortgagee will also protect the mortgagor against any subsequent interests arising through the former owner of the land. On the other hand, in the installment land contract situation there is no third party to stimulate prompt recording. Many unsophisticated vendees do not record and may be prevented from recording by acts of the vendor.¹⁴⁶ Since vendors anticipate a high default rate among vendees, it is in the vendor's interest that the contracts not be recorded so that the vendor may quickly resell to other purchasers without the necessity of a judicial proceeding to remove a title cloud posed by a recorded contract.¹⁴⁷

Suppose, for instance, that after executing the contract, a vendor either mortgages the land or sells it to another. While it is true in many jurisdictions that possession by the original vendee will constitute constructive notice to those dealing with the land thereafter and thus will be the equivalent of recording,¹⁴⁸ this is not universally the case.¹⁴⁹ Further, even if possession is constructive notice, establishing the existence of possession could require litigation,¹⁵⁰ while the fact of a recorded document would not.¹⁵¹

145. See generally *Mixon, Installment Land Contracts: A Study of Low Income Transactions, With Proposals for Reform and a New Program to Provide Home Ownership in the Inner City*, 7 Hous. L. Rev. 523, 545-46 (1970).

146. See *infra* notes 173-76 and accompanying text.

147. See *Mixon, supra* note 145, at 547.

148. See *Life Savings & Loan Ass'n of America v. Bryant*, ___ Ill. App. 3d ___, 467 N.E.2d 277, 282-83 (1984); R. CUNNINGHAM, W. STOEUBUCK, & D. WHITMAN, *PROPERTY* § 11.10 n.33 (1984).

149. See, e.g., *Drey v. Doyle*, 99 Mo. 459, 12 S.W. 287 (1889); Comment, *Possession as Notice Under Missouri Recording Act*, 16 Mo. L. Rev. 142 (1951).

150. See, e.g., *Beals v. Cryer*, 99 Ill. App. 3d 842, 426 N.E.2d 253 (1981) (vendee's mowing of grass and weeds insufficient "visible, open, exclusive and unambiguous" evidence of possession so as to be the equivalent of recording).

151. Failure to record an installment land contract may also cause problems for the

Recent bankruptcy law changes make vendor bankruptcy significantly less troublesome for the vendee than under prior law. Suppose, for example, that four years into a ten-year installment land contract, the vendor files a bankruptcy petition. Section 70(b) of the pre-1978 Bankruptcy Act (the "Prior Act") provided that "the trustee shall assume or reject an executory contract."¹⁵² Because of the rule of *In re New York Investors Mutual Group, Inc.*,¹⁵³ this statutory provision presented serious problems for a vendee. In that case, an installment land contract vendee contended that it was entitled to specific performance against the bankruptcy trustee who had disaffirmed the contract under the above statute. The vendee contended that disaffirmance divested it of its equitable title to the land. However, the court concluded that any rights of the vendee originated solely in the contract and that section 70(b) did not exclude contracts for the sale of real estate from the trustee's power to reject executory contracts.

Professor Warren commented that application of the *New York Investors* rule would leave an installment land contract vendee "with a claim for damages instead of a home."¹⁵⁴ Despite this criticism, subsequent decisions followed *New York Investors*.¹⁵⁵ Scholarly commentary emphasized that the contracts in the foregoing cases may have been executory or earnest money contracts rather than true installment land contracts,¹⁵⁶ but

vendee when the vendor goes into bankruptcy. Section 544(a) of the Bankruptcy Code authorizes a bankruptcy trustee in his status as a hypothetical lien creditor to take advantage of state recording statutes to defeat an unrecorded interest. If, under state law, such a contract is recordable (and they generally are) and an unrecorded interest is invalid against creditors who obtain a judgment lien without notice of the unrecorded interest, a bankruptcy trustee may be able under section 544(a) to avoid the contract. *In re Sayre Village Manor*, 120 F. Supp. 215 (D.N.J. 1954); Lacy, *Land Sale Contracts in Bankruptcy*, 21 UCLA L. REV. 477, 493-97 (1974); Lynn, *Bankruptcy and the Land Sales Contract: The Rights of the Vendee Vis-a-Vis the Vendor's Bankruptcy Trustee*, 5 TEX. TECH L. REV. 677, 694-99 (1974). Normally, however, possession will be the equivalent of recording. See Lacy, *supra*, at 496. In some states where possession is not constructive notice, however, a nonrecording vendee in possession may be vulnerable under section 70(c).

152. 11 U.S.C. § 110(b) (1970).

153. 143 F. Supp. 51 (S.D.N.Y. 1956).

154. Warren, *supra* note 102, at 613.

155. See *Gulf Petroleum v. Collazo*, 316 F.2d 257 (1st Cir. 1963); *In re Philadelphia Penn Worsted Co.*, 278 F.2d 661 (3d Cir. 1960).

156. Lacy, *supra* note 151, at 483.

there was general concern that the principle of *New York Investors* applied to the latter type of contract.¹⁵⁷

Section 365(i) of the Bankruptcy Reform Act of 1978¹⁵⁸ (the "Bankruptcy Code") resolved the above problem in favor of the installment land contract vendee. While the Bankruptcy Code continues to afford the trustee the right to assume or reject executory contracts,¹⁵⁹ when the vendee is in possession the trustee's right to reject the contract is subject to the vendee's right to obtain legal title by completing the payments under the contract.¹⁶⁰ When the vendee is not in possession, the trustee is able to reject the contract and leave the vendee with a claim for damages for breach.¹⁶¹ While the vendee in this latter situation has a lien on the contract property to the extent of prior payments under the contract, he has the status of an unsecured creditor for purposes of recovering other damages.¹⁶² Since most installment land contract vendees normally are in possession, the Bankruptcy Code thus rejects the implications of *New York Investors* for most installment land contracts. On the other hand, with respect to the usual earnest money contract, in which the seller retains possession, and the relatively uncommon installment land contract in which the vendor retains possession, the Bankruptcy Code seems to codify the *New York Investors* result.¹⁶³

Federal tax liens against the vendor should no longer be a problem for the prudent vendee who has a title examined prior to contract execution and who has recorded the contract. If the vendor is delinquent in payment of federal taxes, the United States may obtain a lien on "all property and rights to property, whether real or personal, belonging to [the delinquent tax-

157. See *id.* at 481; Power, *supra* note 9, at 413; Lynn, *supra* note 151, at 689.

158. 11 U.S.C. § 365(i) (1982).

159. *Id.* § 365(a).

160. *Id.* § 365(i). Interestingly, courts have held that an installment land contract is not an "executory contract" in situations in which the vendee is the bankrupt. Thus the vendor will not be able to compel the vendee-bankrupt to assume or reject the contract. See *In re Adolphsen*, 38 Bankr. 780 (D. Minn. 1983); *In re Booth*, 19 Bankr. 53 (D. Utah 1982).

161. 11 U.S.C. § 365(i) (1982).

162. *Id.* § 365(j).

163. Courts continue to experience difficulty with the meaning of "executory contract." See, e.g., *In re Summit Land Co.*, 13 Bankr. 310 (D. Utah 1981). For a consideration of the latter problem, what constitutes possession, and other problems under section 365, see Comment, *Installment Land Contracts and Section 365 of the Bankruptcy Reform Act*, 49 Mo. L. Rev. 337 (1984).

payer].”¹⁶⁴ The tax lien is ineffective against “any purchaser, holder of a security interest, mechanic’s lienor, or judgment lien creditor until notice thereof . . . has been filed”¹⁶⁵ in a designated place. Thus, if a grantee recorded a conveyance of the taxpayer-grantor’s property for adequate and full consideration prior to the filing of a tax lien and without actual knowledge of the lien, the grantee’s title would not be encumbered by the lien. *A fortiori*, if the lien arose after the conveyance, the grantee is protected.

Before the 1966 amendments to the Federal Tax Lien Act, however, there was case law indicating that a vendee who had taken possession under an installment land contract, but who had not received legal title, did not come within the statutory definition of a “purchaser.” Thus, the vendee was subject not only to preexisting unfiled tax liens, but also to liens for taxes arising against the vendor after the contract was executed and the vendee went into possession.¹⁶⁶ Now, however, that problem has been largely obviated by the rule which provides that a person who enters into a written executory contract to purchase property is afforded the protection of a “purchaser” with title.¹⁶⁷ Thus, in most situations the contract vendee who takes possession pursuant to an installment land contract is protected against unfiled tax liens arising against the vendor before the execution of the contract and against all liens arising thereafter.

However, some vendees still face a potential pitfall. Under the Federal Tax Lien Act, protection of the contract vendee as a “purchaser” is “conditioned upon his having taken whatever action is necessary under local law to protect his interest against subsequent purchasers without actual notice.”¹⁶⁸ In most states the contract vendee’s possession qualifies as constructive notice against such subsequent purchasers. However, recording is necessary in those states where possession does not so qualify.¹⁶⁹ Thus a vendee is not fully protected by simply examining title at the time of execution of the contract and promptly going into possession of the land. If a vendee fails to record, he may be

164. 26 U.S.C. § 6321 (1982).

165. *Id.* § 6323(a).

166. *See United States v. Creamer Indus., Inc.*, 349 F.2d 625 (5th Cir.), *cert. denied*, 382 U.S. 957 (1965); *Leipert v. R.C. Williams & Co.*, 161 F. Supp. 355 (S.D.N.Y. 1957).

167. *See* 26 U.S.C. § 6323(h)(6)(B) (1982); *Treas. Reg.* § 301.6323(h)-1(f)(4) Example 1 (1976); W. PLUMB, *FEDERAL TAX LIENS* 73 (3d ed. 1972).

168. PLUMB, *supra* note 167, at 73.

169. *See supra* note 149.

vulnerable not only to preexisting unfiled tax liens, but also to tax liens arising after the execution of the installment land contract.

IX. TITLE PROBLEMS FOR VENDORS

As we pointed out earlier, there have been relatively few title problems for the vendor in states that specifically regulate forfeiture by statutory procedure. In those states, of which Iowa and Minnesota are typical, the statutory procedure for termination has been institutionalized, and the statutes provide a mechanism for establishing record title in the vendor even if the vendee has recorded the contract. However, in states without such statutory mechanisms, and where the forfeiture clause is governed solely or largely by case law, the vendor faces potential title problems. Indeed, in many such jurisdictions, the installment land contract "will provide the . . . vendor with an efficient and cheap method of regaining possession of the contract land and a merchantable title *only* if the vendee fails completely to assert his rights."¹⁷⁰ As one commentator noted:

Thus, if, after default, the vendee moves out of possession, without protest and without having recorded the contract, the vendor will be able to resell the land to a person who will probably qualify as a bona fide purchaser. In practice this probably often happens and may explain, in part, why the installment land contract is continually used. The thing to remember, however, is that *any* device is practical if the other party does nothing to protect his rights.¹⁷¹

On the other hand, suppose the vendee attempts to protect his rights by recording his contract and thereafter goes into default. Even if enforcing forfeiture would be valid under the circumstances, a court will require a judicial proceeding to make that determination. A statement or affidavit that forfeiture has occurred, recorded by the vendor, will probably not suffice.

Thus, the vendor is faced with the costly prospect of a quiet title action or some other judicial proceeding to regain a marketable title. The vendee, for settlement purposes, may very well be able to demand much more than what he has invested in the property as the price for a quit-claim deed.¹⁷²

170. Nelson, *supra* note 23, at 165.

171. *Id.*

172. *Id.*

Some vendors try to eliminate such problems by attempting to prevent the recording of the contract. The most common method used to accomplish this is to omit an acknowledgment of the parties' execution of the contract. For any vendee represented by counsel, however, this method is easily circumvented by recording an affidavit in which the vendee refers to the installment land contract and attaches the contract as an exhibit. Or, as a variation, the vendee could execute and record an affidavit that incorporates the essential terms of the contract, including the legal description, the parties, and the important terms. Occasionally, a vendor will attempt to prevent recording by keeping *all* copies of the contract. However, the vendee could still probably use the second affidavit method described above. After all, if in fact a land contract exists, it would surely not be improper for a vendee to summarize the terms of that contract in an affidavit. In jurisdictions that do not permit recordation of affidavits and where state statutes prohibit recording of land sale contracts unless acknowledged by vendors,¹⁷³ an effective variant might be to record an acknowledged assignment of the vendee's interest to a straw party and a reassignment back to the vendee.¹⁷⁴

Occasionally, a vendor attempts to discourage recording by the vendee by including a provision in the installment land contract making recording of the contract a ground for default and forfeiture. Such provisions may have a substantial deterrent effect because the risk of forfeiture should never be taken lightly. Nevertheless, such provisions probably violate the public policy of encouraging recording of interests in real estate. Indeed, Professor Warren has indicated that it is doubtful that such clauses would be effective "to attain anything more than the hostility of the judge who has to interpret the contract."¹⁷⁵

173. See FLA. STAT. ANN. § 696.01 (West 1969); *Coggins v. Mimms*, 373 So. 2d 964 (Fla. Dist. Ct. App. 1979).

174. Nelson, *supra* note 23, at 165-66. As we shall see, a vendee's interest is mortgageable. See *infra* note 191 and accompanying text. Thus, even if a vendee does not record, a recorded mortgage from the vendee will similarly cloud the title. In any event, it seems unlikely that the recording methods referred to in the text would constitute slander on the vendor's title. See Nelson, *supra* note 23, at 166; see also *Ridgewood Utilities Corp. v. King*, 426 So. 2d 49 (Fla. Dist. Ct. App. 1982) (land contract was recorded but not entitled to recordation because unacknowledged by vendor; vendor had no cause of action for slander of title where there was no showing that the contract as recorded was false and that vendor was damaged as a result of the recording).

175. Warren, *supra* note 102, at 629.

Stated simply, in states where the above title complications to the vendor can occur, the installment land contract can be a "pro-vendee" financing device. When, for example, such contracts are used in wholesale fashion as substitute financing devices in low income, low down payment situations, mass recording of such contracts by vendees could increase the vendees' practical economic interests in the involved real estate. Another possible result is pervasive title clouds on substantial amounts of real estate.

The foregoing, of course, is not intended to deemphasize the risks for the vendee under installment land contracts. Many of these risks have been discussed previously. When the vendee has paid a substantial amount on the contract and then defaults, the vendor may choose to go to court to enforce a forfeiture clause. Notwithstanding clouds on the vendor's title, what if the court determines that forfeiture is reasonable? In that event a vendee could lose his entire equity without a public sale. In addition, some local recorders may occasionally block attempts by vendees to record evidence of their contracts.¹⁷⁶ In other words, the installment land contract device means, at best, uncertainty for both sides.

It is perhaps understandable that, notwithstanding the above risks, installment land contracts would be used in states where mortgages must be foreclosed by a costly and time-consuming judicial action. This helps explain why installment land contracts are popular in Iowa and Illinois, where such a judicial proceeding is the only foreclosure remedy. On the other hand, in many states, of which Missouri and Utah are typical, where the power of sale mortgage or deed of trust is permissible and where foreclosure is efficient and relatively inexpensive, reliance on the installment land contract is difficult to understand or justify.¹⁷⁷

We suggest several possible explanations for the widespread use of installment land contracts. First, the use of installment land contracts may spill over from states where they have been used successfully to adjacent states where such use is especially

176. Such action on the part of the recorder may be unjustified or based on statutory restrictions. *See supra* note 173.

177. While it is true that power of sale foreclosure has been under constitutional attack on fourteenth amendment due process hearing and notice grounds, those attacks have been meeting with diminishing success, primarily due to the reluctance of the courts to find state action in foreclosures by nongovernmental leaders. *See supra* notes 103-17 and accompanying text.

dangerous for vendors. Second, many vendors may use land contracts in low down payment situations and take their chances that the vendees will be unsophisticated. Finally, many vendors may simply want to feel assured that they will receive their land back if the vendee defaults. With a mortgage or a deed of trust, of course, the mortgagee must ultimately foreclose against a defaulting mortgagor; a third party could purchase at the sale, leaving the mortgagee with money and not land. Nonetheless, in view of the uncertainty of the enforceability of the forfeiture clause in many, if not most, jurisdictions, reliance on the forfeiture clause to regain one's land is probably misplaced.¹⁷⁸

Many vendors erroneously believe that using an installment sale contract rather than a purchase money mortgage is necessary to qualify the sale for installment reporting under Section 453 of the Internal Revenue Code. In fact the form of the document is unimportant.¹⁷⁹ The confusion probably arises from the similarity of the Code's terminology under Section 453 to that applied to real estate installment contracts.

However, one could argue that a more subtle reason exists for preferring the installment land contract. To understand it, some background information on Section 453's operation is necessary. Its objective is to tax each payment received by the seller in proportion to the fraction of the total gain which that payment represents; thus, the gain and the tax may be spread over several taxable years. Specifically, the gain taxed on each payment is the amount of the payment multiplied by the *gross profit ratio*. The *gross profit ratio*, in turn, is defined as the *gross profit* (in essence, the gain) from the sale, divided by the *contract price*.¹⁸⁰ Mathematically, the formula is:

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Contract Price}}$$

Ordinarily when the seller is taking installment reporting under Section 453 and the purchaser assumes or takes subject to an

178. See Nelson, *supra* note 23, at 167-68.

179. See 26 U.S.C. § 453(b)(1) (1982), defining an installment sale as "a disposition of property . . . where at least one payment is to be received after the close of the taxable year in which the disposition occurs." Section 453 was extensively amended by the Installment Sales Revision Act of 1980, Pub. L. No. 96-471, 94 Stat. 2247, but its application to both installment contracts and purchase money mortgages was unchanged.

180. See 26 U.S.C. § 453(c) (1982); Treas. Reg. § 15A.453-1(b)(2) (1981); Emory & Hjorth, *An Analysis of the Changes Made by the Installment Sales Revision Act of 1980—Part I*, 54 J. TAX'N 66 (1981).

existing mortgage on the property, the amount of the mortgage is treated as reducing the contract price.¹⁸¹ But when the mortgage amount exceeds the seller's basis in the property, that excess of mortgage over basis does *not* reduce the contract price.¹⁸² Instead, the excess is treated as being received by the seller in the year of the sale.¹⁸³ For properties with large mortgages, but in which the seller has a low basis, this may be a very undesirable result, as it will tend to "bunch" more gain into the year of the sale.

The Tax Court in several cases has held that this result does not follow if the sale is a "wraparound" one, under which the seller continues to make the payments on the underlying mortgage. Under this arrangement the buyer makes payments only to the seller, and their amount is computed as if no prior mortgage exists on the property.¹⁸⁴ The court took the view that in a wraparound sale the underlying mortgage is neither being assumed nor taken subject to in an economic sense. Thus, there

181. Temp. Treas. Reg. § 15A.453-1(b)(2)(iii) (1981). This reduction of selling price by the mortgage amount has the effect of increasing the gross profit ratio and therefore of taxing a higher percentage of each actual payment received by the seller.

182. *Id.* If the full amount of the mortgage, including the part exceeding basis, were applied to reduce the contract price, the denominator of the fraction (the contract price) would be less than the numerator (the gross profit), and the gross profit ratio would be greater than 100%. This would be unfair to the seller, since he has already been separately taxed at the closing on the excess of mortgage over basis.

To illustrate, assume a property with a basis of \$20,000, a mortgage of \$60,000 and a selling price of \$100,000. If the full mortgage were applied to reduce the contract price, the gross profit ratio would be

$$\frac{\text{Gross Profit}}{\text{Contract Price}} = \frac{80,000}{100,000 - 60,000} = 200\%$$

However, since the amount of mortgage in excess of basis does not reduce the contract price, the gross profit ratio is instead

$$\frac{\text{Gross Profit}}{\text{Contract Price}} = \frac{80,000}{100,000 - 20,000} = 100\%$$

See Comment, *Receipt of Payment in Installment Sales Transactions: Wraparound Mortgages and Letters of Credit*, 61 NEB. L. REV. 499, 506 (1982).

183. See Temp. Treas. Reg. § 15A.453-1(b)(3)(i) (1981). Thus, in the example in the preceding footnote, the seller would be treated as receiving the excess of mortgage over basis, or \$40,000, in the year of sale (plus, of course, any actual cash payments received in that year). This aspect of the regulations was even more important prior to the Installment Sales Revision Act of 1980, since under the preceding law installment reporting was disallowed if the seller received more than 30% of the selling price in the year of sale. The amount of mortgage in excess of basis might well be enough to eliminate installment reporting.

184. See NELSON & WHITMAN, *supra* note 3, § 5.16 for a detailed discussion of wrap-around mortgages.

should be no reduction in the contract price to reflect the mortgage amount, and, most importantly, the seller should not be regarded as receiving the excess of mortgage over basis in the year of sale.¹⁸⁵

In its most recent regulations the IRS has explicitly rejected this position of the Tax Court and has held that wraparound transactions are no different than ordinary assumption or subject-to transfers for purposes of installment reporting.¹⁸⁶ However, no clear warrant exists in the statute or the legislative history for the Service's position, and the regulations might be held invalid.¹⁸⁷ Parties planning a transaction with this eventuality in mind might wish to structure it so as to qualify under the earlier Tax Court cases. Nearly all those cases involved installment land contracts rather than purchase money mortgages, and retention of legal title by the seller may have been an important factor in the outcome.¹⁸⁸ The Tax Court has never clarified this point.¹⁸⁹ Thus, a cautious planner designing a wraparound sale for the most advantageous installment sale reporting might conclude that the installment land contract is preferable to a mortgage. In light of the Service's regulations, however, the argument for use of the installment contract is attenuated.¹⁹⁰

185. See *United Pacific Corp. v. Comm'r*, 39 T.C. 721 (1963); *Estate of Lamberth v. Comm'r*, 31 T.C. 302 (1958); *Stonecrest Corp. v. Comm'r*, 24 T.C. 659 (1955); Comment, *supra* note 182, at 511-521. The rationale of these cases seems to be based on the seller's continuing personal obligation to make the payments on the underlying mortgage, so that the buyer cannot be regarded as having either assumed or taken subject to it in an economic sense. It is clear, of course, that whatever title passes to the buyer is encumbered by the mortgage, so that in real property terms it has been taken "subject to."

186. Temp. Treas. Reg. § 15A.453-1(b)(3)(ii) (1981) (applying to installment sales after March 4, 1981). This regulation is consistent with the litigating position of the IRS in the cases cited in the foregoing footnote. Under the regulations, it is immaterial whether title has passed to the buyer.

187. See Comment, *supra* note 182, at 525-30.

188. In two private letter rulings prior to the issuance of the present regulations, the IRS attempted to distinguish the Tax Court cases on the ground that they involved installment land contracts with no transfer of legal title. See Priv. Ltr. Rul. 7,814,011 (Dec. 29, 1977); Priv. Ltr. Rul. 7,814,010 (Dec. 23, 1977). The proposition that the tax treatment of the wraparound sale ought to depend on the location of legal title is, on its merits, very dubious. See Comment, *supra* note 182, at 528 n.168. But see Gallagher, *Wraparound Mortgages and Deferred Payment Sales of Real Property*, 56 TAXES 400 (1978).

189. The Tax Court explicitly refused to decide whether retention of title was relevant to its wraparound mortgage position in *Goodman v. Comm'r*, 74 T.C. 684, 712 n.16 (1980).

190. Attempting to qualify the transactions under the Tax Court's cases is frustrating in another way as well. If the seller in a wraparound transaction is not a financial institution or a party of excellent credit and solvency, the buyer is well advised to make

X. MORTGAGING THE VENDEE'S INTEREST—PROBLEMS FOR MORTGAGEES

As a vendee pays off his obligations under an installment land contract and particularly if the land goes up in value, the vendee's interest can become a significant economic asset. Thus, it is common practice for a vendee to seek to borrow money by using his interest in the land as security for a loan. Functionally, of course, a mortgage on a vendee's interest is the economic equivalent of a second mortgage, because the vendor holds an interest analogous to a first purchase money mortgage on the land. Increasingly, the case law recognizes the proposition that the vendee's interest is mortgageable.¹⁹¹

To state this latter proposition, however, raises some serious questions. The determination that the vendee has an interest which can be mortgaged is of little use unless the mortgagee has some way to protect his interest against the vendor's declaration of forfeiture.

Thus, the cases overwhelmingly hold that when the vendor has actual knowledge of the vendee's mortgagee, he cannot declare a forfeiture of an installment land contract without giving the vendee's mortgagee both notice of intent to forfeit and an opportunity to protect himself.¹⁹² Furthermore, under the rea-

each regular payment into some form of trust, agency, or escrow arrangement, with the trustee or agent having authority to split the funds, pay the amount due on the underlying mortgage directly, and turn the remainder over to the seller. This approach is good assurance against the possibility of the seller's default in making the payments on the prior mortgage. Unfortunately, the Tax Court has held that if such an arrangement is used, the entire mortgage in excess of basis must be realized as income in the year of the sale, thus destroying the hoped-for tax advantage of the wraparound sale. *See Goodman v. Comm'r*, 74 T.C. 684 (1980).

191. *See Davis v. Davis*, 88 Ala. 523, 6 So. 908 (1889); *Stannard v. Marboe*, 159 Minn. 119, 198 N.W. 127 (1924); *Fincher v. Miles Homes, Inc.*, 549 S.W.2d 848 (Mo. 1977); *O'Neill Prod. Credit Ass'n v. Mitchell*, 209 Neb. 206, 307 N.W.2d 115 (1981); *Shindledecker v. Savage*, 96 N.M. 42, 627 P.2d 1241 (1981); *Bill Nay & Sons Excavating v. Neeley Const. Co.*, 677 P.2d 1120 (Utah 1984). *But see Arkansas Supply, Inc. v. Young*, 265 Ark. 281, 580 S.W.2d 174 (1979) (where a vendee had paid only \$150 of a \$15,000 purchase price under an installment land contract, he did not possess a mortgageable interest).

Such a mortgage typically is perfected against third party claimants of the vendee by recording it in the real estate records. Perfection under Article 9 of the Uniform Commercial Code is probably unnecessary. *See In re Chimento*, 43 Bankr. 401 (Bankr. Ohio 1984).

192. *See, e.g., Credit Finance, Inc. v. Bateman*, 135 Ariz. 268, 660 P.2d 869 (1983); *Lockhart Co. v. B.F.K. Ltd.*, 691 P.2d 1248 (Ida. App. 1984); *Fincher v. Miles Homes, Inc.*, 549 S.W.2d 848 (Mo. 1977); *Stannard v. Marboe*, 159 Minn. 119, 198 N.W. 127 (1924); *Shindledecker v. Savage*, 96 N.M. 42, 627 P.2d 1241 (1981) (dictum); *Kendrick v.*

soning of some of the cases, even when the vendor lacks actual knowledge of the vendee's mortgagee, recording by the vendee's mortgagee constitutes constructive notice to the vendor that the mortgagee exists. This constructive notice imposes a duty on the vendor to examine the title to the land prior to declaring a forfeiture in order to ensure that notice can be given to any subsequent mortgagee of the vendee's interest.¹⁹³ On the other hand, some courts have held that, absent actual knowledge of the mortgagee's existence, the vendor is under no obligation to notify the mortgagee of his intent to declare a forfeiture.¹⁹⁴ This latter approach relies on the notion that recording an instrument constitutes notice only to those acquiring interest in the land subsequent to a recording and not to those whose interest predated that recording. The practical effect of such reasoning is that a mortgagee, in order to protect himself, must give actual notice to the vendor at the time the mortgagee takes his security interest.¹⁹⁵

Assuming that notice of an intent to invoke forfeiture reaches the vendee's mortgagee, how may the mortgagee protect himself? It has been suggested that notice would permit the mortgagee to fulfill the obligations of the vendee under the contract.¹⁹⁶ If this means that the mortgagee may take over the vendee's interest without foreclosure of the mortgage, it would seem to be clearly erroneous, since it would confer on a mortgagee of the vendee greater rights than those possessed by a second mortgagee in the normal mortgage situation. In the normal situation, the second mortgagee has two options when the senior mortgage goes into default. First, he may pay off or redeem the senior mortgage and stand in the senior's shoes as an assignee of that mortgage. At that point, the second mortgagee would own two mortgages on the land and would have to foreclose one or both

Davis, 75 Wash. 2d 456, 452 P.2d 222 (1969). *Contra* Estate of Brewer v. Iota Delta Chapter, — Ore. —, 692 P.2d 597 (1984). See also Roberts v. Morin, 198 Mont. 233, 645 P.2d 423 (1982) (vendee who resells land on second installment land contract entitled to notice from the original vendor prior to declaration of forfeiture of the first contract).

193. See, e.g., Stannard v. Marboe, 159 Minn. 119, 198 N.W. 127 (1924); see also 45 WASH. L. REV. 645, 646 (1970).

194. See, e.g., Kendrick v. Davis, 75 Wash. 2d 456, 452 P.2d 222 (1969); Shindedecker v. Savage, 96 N.M. 42, 627 P.2d 1241 (1981).

195. For a cogent criticism of this approach, see Note, *Mortgages—Mortgage of a Vendee's Interest in an Installment Land Contract—Mortgagee's Rights Upon Default*, 43 Mo. L. REV. 371, 373-374 (1978).

196. See 45 WASH. L. REV. 645, 646 (1970).

of them in order to acquire either money or title to the land. Alternatively, the second mortgagee could foreclose his mortgage, and the purchaser at that sale would buy the land subject to the first mortgage.¹⁹⁷ The foreclosing second mortgagee would get title only if he were the successful purchaser at the sale. Otherwise the second mortgagee would have his lien paid off. But in no event can the second mortgagee acquire title to the land without himself foreclosing.

In applying the mortgage analogy to the installment land contract situation, it would seem that the vendee's mortgagee should have no greater rights than a "normal" second mortgagee. In other words, the vendee's mortgagee should have two options. First, he could pay off the defaulted land contract and have all the rights of an assignee of the vendor under that contract. Assuming forfeiture is enforceable in his jurisdiction, the mortgagee-assignee presumably could then himself invoke the forfeiture rights under the contract.¹⁹⁸ But in no event should he be able to eradicate the vendee's interest without invoking the functional equivalent of foreclosure. Second, the mortgagee could choose to foreclose his mortgage on the vendee's interest. In that case the purchaser at the sale would buy the land subject to the vendor's rights.¹⁹⁹ The mortgagee would either purchase the land himself or be paid out of the proceeds of the sale. This second option is, of course, highly risky, because if the vendor is able to invoke forfeiture promptly, the purchaser at the vendee's mortgagee's foreclosure sale may simply be buying nothing.

Very often, mortgagees of a vendee's interest make the mistake of taking an assignment of the vendee's interest and a quitclaim deed from the vendee as security for the loan to the vendee. This transaction, of course, will be treated substantively as a mortgage.²⁰⁰ The problem is that the use of such documents means that the mortgagee's second option, foreclosure of his

197. See NELSON, *supra* note 16, at 497-499.

198. See Note, *supra* note 195, at 376-377. But see *Knauss v. Miles Homes, Inc.*, 173 N.W.2d 896 (N.D. 1969).

199. See Note, *supra* note 195, at 376-377. Alternatively, the mortgagee may obtain a deed in lieu of foreclosure from the vendee; see *Erickson v. First Nat'l Bank*, _____ Mont. _____, 697 P.2d 1332 (1985).

200. See *Erickson v. First Nat'l Bank*, _____ Mont. _____, 697 P.2d 1332 (1985); *O'Neill Prod. Credit Ass'n v. Mitchell*, 209 Neb. 206, 307 N.W.2d 115 (1981); *Kendrick v. Davis*, 75 Wash. 2d 456, 452 P.2d 222 (1969); *Cunningham & Tischler, Disguised Real Estate Security Transactions as Mortgages in Substance*, 26 *RUTGERS L. REV.* 1 (1972).

mortgage, must be accomplished by a costly and time-consuming judicial action. This is so because the assignment and quitclaim deed will contain no power of sale, so that even if the particular jurisdiction permits nonjudicial foreclosure, the mortgagee could not utilize that remedy. Thus, if a mortgage on a vendee's interest is desired and if the applicable jurisdiction permits nonjudicial foreclosure, the mortgagee of the vendee should utilize a mortgage or deed of trust with an express power of sale instead of the assignment and quitclaim documents.

XI. JUDGMENTS AGAINST PARTIES TO INSTALLMENT LAND CONTRACTS

In almost all states a judgment creates a lien on the real, but usually not the personal, property of the judgment debtor.²⁰¹ While the mechanics of obtaining a lien and the lien's effective date vary somewhat, typically a lien applies to all real estate of the judgment debtor in the county in which the judgment is docketed by a court clerk in an appropriate docket book.²⁰² The time of docketing usually determines lien priority. Consequently, when the judgment debtor is either a vendee or vendor under an installment land contract, the characterization of the debtor's interest as real or personal property can be crucial in determining the rights of the judgment creditor.

A. *Judgments Against Vendee*

Most states hold that the vendee's interest is real estate for purposes of judgment lien legislation and that a judgment creditor of a vendee thus obtains a valid lien on the vendee's contract interest.²⁰³ The practical implications of this rule can be illustrated by a hypothetical. Suppose that a vendee has paid off \$40,000 of an installment land contract price of \$100,000. The land then has a fair market value of \$100,000 free and clear of liens. The vendee's creditor then docketes a \$15,000 judgment

201. See D. EPSTEIN, *DEBTOR-CREDITOR LAW* 46, 52-53 (2d ed. 1980).

202. See, e.g., MINN. STAT. ANN. § 548.09 (West Supp. 1985); MO. ANN. STAT. § 511.350 (Vernon Supp. 1985); UTAH CODE ANN. § 78-22-1 (Supp. 1983); D. EPSTEIN, *supra* note 201, at 46.

203. See, e.g., *Mutual Bldg. & Loan Ass'n v. Collins*, 85 N.M. 706, 516 P.2d 677 (1973); *Fridley v. Munson*, 46 S.D. 532, 194 N.W. 840 (1923); *Bill Nay & Sons Excavating v. Neeley Const. Co.*, 677 P.2d 1120 (Utah 1984); *Utah Coop. Ass'n v. White Distrib. and Supply Co.*, 120 Utah 603, 237 P.2d 262 (1951); *Cascade Security Bank v. Butler*, 88 Wash. 2d 777, 567 P.2d 631 (1977).

against the vendee in a county where the contract land is located. The vendee then borrows \$30,000 from the mortgagee and gives it a mortgage on the contract land. The mortgagee promptly records the mortgage. The vendee then defaults on the mortgage and the mortgagee forecloses. Because the judgment against the vendee is a valid lien on the vendee's interest and because it was docketed prior to execution and recordation of the mortgage, the purchaser at the foreclosure sale will buy the vendee's interest subject to the judgment lien.

Courts justify the foregoing result either as an application of the equitable conversion concept or as a matter of statutory interpretation. Under the equitable conversion theory, from the time an earnest money or installment land contract is executed, the vendee's interest is considered in equity to be real estate while the vendor's retention of legal title and the right to receive the balance of the purchase price is deemed to be personalty.²⁰⁴ Other courts eschew the equitable conversion approach and simply hold that the legislature intended that the vendee's interest be treated as real estate for purposes of judgment lien legislation.²⁰⁵ These courts prefer the statutory construction approach because they are concerned over the uncertainty of the equitable conversion concept and the implications that its application would create for other areas, such as devolution at death, wills and trusts.²⁰⁶

A judgment creditor of a vendee must sometimes cope with a related and potentially more troublesome issue. Some courts have held that a judgment lien does not attach to equitable interests in real estate. Accordingly, a contract vendee's interest, being equitable, is not subject to the lien.²⁰⁷ Increasingly, how-

204. *Mutual Bldg. & Loan Ass'n v. Collins*, 85 N.M. 706, 516 P.2d 677 (1973); *Bartz v. Paff*, 95 Wis. 95, 69 N.W. 297 (1897); cf. *Westfair Corp. v. Kuelz*, 90 Wis. 2d 631, 280 N.W.2d 364 (1979); R. LEAVELL, J. LOVE & G. NELSON, *EQUITABLE REMEDIES AND RESTITUTION* 356-57 (3d. ed. 1980); R. CUNNINGHAM, W. STOEBCUK & D. WHITMAN, *PROPERTY* § 10.13 nn.14-24 (1984); Hume, *Real Estate Contracts and the Doctrine of Equitable Conversion in Washington: Dispelling the Ashford Cloud*, 7 U. PUGET SOUND L. REV. 233, 240 (1984).

205. *Joseph v. Donovan*, 114 Conn. 79, 157 A. 638 (1931); *Hoffman v. Semet*, 316 So. 2d 649 (Fla. Dist. Ct. App. 1975); *Cascade Security Bank v. Butler*, 88 Wash. 2d 777, 567 P.2d 631 (1977); Note, *Article 9 Governs Assignment of Vendor's Rights Under an Installment Land Contract as Security for a Debt*, 47 Mo. L. REV. 328, 331 (1982).

206. See, e.g., *Cascade Security Bank v. Butler*, 88 Wash. 2d 777, 567 P.2d 631 (1977).

207. See, e.g., *Cheves v. First Nat'l Bank*, 79 Fla. 34, 83 So. 870 (1920); *Warren v. Rodgers*, 82 N.M. 78, 475 P.2d 775 (1970); *FCX, Inc. v. Long Meadow Farms, Inc.*, 269

ever, courts are interpreting judgment lien legislation broadly to make equitable, as well as legal, interests subject to the lien.²⁰⁸ Consequently, it is becoming more likely that a judgment lien will attach to an installment vendee's interest notwithstanding its equitable nature.²⁰⁹

B. Judgments Against Vendor

Despite the equitable conversion theory, the majority of jurisdictions treat the vendor's installment land contract interest as real estate for purposes of judgment lien statutes.²¹⁰ Thus, as one court stated, the judgment lien "extends to all of the vendor's interest remaining in the land and binds the land to the extent of the unpaid purchase price."²¹¹ One basis for this theory is that the vendor has a real estate interest because he or she retains legal title to the land until the contract is fully paid and the deed is delivered to the vendee.²¹² Perhaps an equally plausible basis for the majority rule is simply that the vendor has an interest in real estate to the extent of the unpaid purchase price.²¹³

A minority of jurisdictions characterize the vendor's interest as personalty for purposes of judgment lien legislation.²¹⁴ This result is based not only on the fact that, for purposes of the equitable conversion doctrine,²¹⁵ the vendor has personalty, but also on the notion that, since courts overwhelmingly characterize

S.C. 202, 237 S.E.2d 50 (1977); Annot., 1 A.L.R.2d 717 (1948).

208. See *Mutual Bldg. & Loan Ass'n v. Collins*, 85 N.M. 706, 516 P.2d 677 (1973) (overruling *Warren v. Rogers*, 82 N.M. 78, 475 P.2d 775 (1970)); *Fridley v. Munson*, 46 S.D. 532, 194 N.W. 840 (1923); *Eckley v. Bonded Adjustment Co.*, 30 Wash. 2d 96, 190 P.2d 718 (1948).

209. See, e.g., *Mutual Bldg. & Loan Ass'n v. Collins*, 85 N.M. 706, 516 P.2d 677 (1973).

210. See, e.g., *Chain O'Mines, Inc. v. Williamson*, 101 Colo. 231, 72 P.2d 265 (1937); *First Sec. Bank v. Rogers*, 91 Idaho 654, 429 P.2d 386 (1967); *Bauermeister v. McDonald*, 124 Neb. 142, 247 N.W. 424 (1932); *Heider v. Dietz*, 234 Or. 105, 380 P.2d 619 (1963); *Heath v. Dodson*, 7 Wash. 2d 667, 110 P.2d 845 (1941); Note, *supra* note 206, at 330-31.

211. *First Sec. Bank v. Rogers*, 91 Idaho 654, 429 P.2d 386 (1967).

212. Note, *supra* note 205, at 331.

213. Lacy, *supra* note 151, at 505.

214. See, e.g., *Marks v. City of Tucumcari*, 93 N.M. 4, 595 P.2d 1199 (1979); *Mueller v. Novelty Dye Works*, 273 Wis. 501, 78 N.W.2d 881 (1956); Church, *Equitable Conversion in Wisconsin*, 1970 Wis. L. Rev. 404, 418-19.

215. See *Marks v. City of Tucumcari*, 93 N.M. 4, 595 P.2d 1199 (1979); *Mueller v. Novelty Dye Works*, 273 Wis. 501, 78 N.W. 2d 881 (1956).

the vendee's interest as real estate, it is illogical that the vendor should have a real estate interest as well.²¹⁶

Again, an example is helpful in understanding the implications of the majority and minority approaches. Suppose that an installment contract vendor is still entitled to collect \$50,000 over the next four years. X then docketed a \$20,000 judgment against the vendor in the county where the contract land is located. Y then docketed a \$40,000 judgment against the vendor in the same county. Y holds an execution sale on the judgment and purchases at the sale for \$40,000. In a majority rule state, Y clearly paid too much. Under the majority rule the vendor's interest is real estate and thus both judgments are liens on that interest. Their relative priority is determined by the date each judgment was docketed. Accordingly, since Y's judgment was docketed later than X's judgment, Y purchased the vendor's interest subject to X's unpaid \$20,000 lien. On the other hand, Y is much better off if the foregoing fact situation occurs in a minority jurisdiction. In such states the vendor's interest is personalty. As such, a judgment creditor can obtain no interest in it until it is levied upon by the sheriff pursuant to the issuance of a writ of execution.²¹⁷ The date of judgment docketing establishes no priority; rather, the first execution sale passes title to the personalty free and clear of any other judgment no matter when it was docketed. Thus, in our example, even though Y's judgment was obtained after X's, Y purchased at the execution sale a title free and clear of any lien in favor of X.

XII. MORTGAGING THE VENDOR'S INTEREST—PROBLEMS FOR MORTGAGEES

The vendor's interest in an installment land contract is clearly mortgageable.²¹⁸ Traditionally, those who lend money on the security of a vendor's interest commonly treat the transaction as a simple mortgage on a fee interest in real estate. In other words, the lender assumes that because the vendor holds legal title, he or she is the "real owner" of the land described in the contract until the contract is fully paid off. Consequently,

216. Note, *supra* note 205, at 331.

217. See D. ERSTEIN, *supra* note 201, at 52-53.

218. See, e.g., *Erickson v. First Nat'l Bank*, ___ Mont. ___, 697 P.2d 1332 (1985); *Cain & Bultman, Inc. v. Miss Sam, Inc.*, 409 So. 2d 114 (Fla. Dist. Ct. App. 1982); *In re Freeborn*, 94 Wash. 2d 336, 617 P.2d 424 (1980).

the lender takes a regular mortgage and an assignment of the vendor's contract interest. The lender usually records the mortgage and sometimes the assignment in the real estate records. As a variant, instead of taking a mortgage, the lender may take a deed to the contract land together with an assignment and then record one or both in the real estate records.²¹⁹

The foregoing practice is usually assumed to protect the lender's priority against both unsecured and subsequent lien creditors of the vendor. However, a Washington Supreme Court decision, *In re Freeborn*,²²⁰ calls this practice and its underlying assumptions into serious question. The Washington Supreme Court held that if the vendor's lender desires to have a security interest in the vendor's right to receive the contract payments that will have priority over claims against those payments by subsequent lien creditors, including a trustee in bankruptcy, the vendor's lender must perfect that claim as a chattel security interest under article 9 of the Uniform Commercial Code. The court's reasoning was premised on the notion that the vendor has both legal title to the land (realty) and the right to receive the contract payments (personalty). The court further reasoned that while taking and recording a mortgage or similar documents in the land records protects the lender against subsequent claims to the vendor's legal land title, it does not protect the lender against subsequent claims on the vendor's right to receive the contract payments. Since only real estate recording had occurred, the security interests in *Freeborn* were deemed unperfected.

The *Freeborn* court found support for its conclusion that the vendor's right to receive the contract payments was personality in an earlier Washington decision²²¹ that characterized the vendor's installment land contract interest as personality for community property purposes. In addition, it relied on *Cascade Security Bank v. Butler*,²²² which, while rejecting the application of the equitable conversion concept,²²³ held that an installment vendee's interest was real estate for purposes of Washington's judgment lien statute. The *Freeborn* court also emphasized

219. See, e.g., *In re Freeborn*, 94 Wash. 2d 336, 617 P.2d 424 (1980).

220. *Id.*; see Note, *supra* note 205.

221. *Meltzer v. Wendell-West*, 7 Wash. App. 90, 497 P.2d 1348 (1972).

222. 88 Wash. 2d 777, 567 P.2d 631 (1977).

223. *Id.*; see Hume, *supra* note 204, at 233.

other Washington case law holding the vendor's contract interest to be personalty.²²⁴

More significant, however, is the *Freeborn* court's article 9 analysis, which is based on a straight mortgage transaction analogy. The court cited an official comment to section 9-101(3) which states that although article 9 does not apply to the creation of a real estate mortgage itself, "when the mortgagee pledges the note to secure his own obligation to X, this Article applies to the security interest thus created, which is a security interest in an instrument even though the instrument is secured by a real estate mortgage."²²⁵ The court reasoned that the situation described in the comment—"where the mortgagee pledges the note to secure his own obligation to a third party—[was] analogous to the [case before it]. Here, the vendor and holder of legal title assigned the right to receive real estate contract payments in order to secure his obligation to a third party."²²⁶ Finally, the court relied on a Florida federal trial court decision²²⁷ for the proposition that article 9 "applied to security interests in 'realty paper'" and for its holding that article 9 governed where installment land contracts were delivered to the vendor's lender pursuant to security pledge agreement.

The *Freeborn* approach has been followed by several other courts.²²⁸ By analogizing installment contracts to notes secured by mortgages, the *Freeborn* court followed the current trend. Under this analysis the case is partly correct and partly wrong. It is now becoming clear that article 9 of the Uniform Commercial Code applies to the perfection of security interests in mortgage notes.²²⁹ On this point *Freeborn* was right. The method of

224. *Pierce County v. King*, 47 Wash. 2d 328, 287 P.2d 316 (1955) (vendor's interest is personalty for inheritance tax purposes); *In re Eilermann's Estate*, 179 Wash. 15, 35 P.2d 763 (1934) (vendor's interest is personalty for purposes of succession and administration).

225. U.C.C. § 9-102 official comment 4 (1978).

226. 94 Wash. 2d at 343, 617 P.2d at 428.

227. *In re Equitable Dev. Corp.*, 20 U.C.C. Rep. Serv. (Callaghan) 1349 (S.D. Fla. 1976).

228. *In re Southworth*, 22 Bankr. 376 (D. Kan. 1982) (both realty and Code filing necessary); *In re Shuster*, 47 Bankr. 920 (D. Minn. 1985) (Code filing necessary, realty filing left open). *In re S.O.A.W. Enterprises, Inc.*, 32 Bankr. 279 (W.D. Tex. 1983) (Code filing sufficient); *In re Equitable Dev. Corp.* 20 U.C.C. Rep. Serv. (Callaghan) 1349 (S.D. Fla. 1976) (Code filing sufficient).

229. See *In re Staff Mortgage & Inv. Co.*, 625 F.2d 281 (9th Cir. 1980); *In re Kennedy Mortgage Co.*, 17 Bankr. 957, 964-65 (D.N.J. 1982). See generally NELSON & WHITMAN, *supra* note 3, § 5.28 n.40.

perfection for notes, which is transfer of possession to the secured party, probably does not apply to installment contracts, since they are evidently not "instruments" as the Uniform Commercial Code employs the term.²³⁰ Hence, an installment contract is correctly understood to be a "general intangible" in the Code's parlance; and a security interest in it must be perfected by the filing of a financing statement.²³¹ But with respect to the real property interest, *Freeborn's* attempt to assimilate installment contracts to mortgages breaks down. It is well recognized that an assignment of a mortgage note will carry the mortgage with it automatically.²³² The cases are increasingly taking the view that, even when the transfer is for security purposes, the mortgage will attach to the note when it is delivered into the hands of the pledgee, and will be regarded as perfected irrespective of whether any assignment was recorded in the real estate records.²³³ *Freeborn* displays no awareness of these cases, and instead insists on treating the realty interest as a separate species which must be perfected—by recording—in its own right.

Surely this is a waste of effort. Conceptually the real estate interest may be separated from the payment stream, but the separation is meaningless in practical terms. If one holds the realty interest but has no right to the payments, his interest has no value. He obviously cannot sue for damages, specific performance, or any other money remedy. He cannot declare a forfeiture because no debt is owed to him. His "rights" are as empty and useless as those of a mortgagee when someone else holds the note; they are nugatory.²³⁴

Why, then, put the pledgee of the vendor's interest at risk of losing his security in the land if he does not record in the real estate records? Certainly one recording—in the financing statement files—is sufficient if practitioners and the public know that

230. See U.C.C. § 9-105(i) (1978), defining an "instrument" as a paper "of a type which is in ordinary course of business transferred by delivery with any necessary endorsement or assignment." Customs vary from one area of the nation to another, but it would be difficult to say that there is a broad custom of transferring or pledging installment contracts by delivery of the original contract document. Perfection of a security interest in an "instrument" can be accomplished only by delivery. U.C.C. § 9-304(1) (1978).

231. U.C.C. § 9-106 (1978). A security interest in a "general intangible" can be perfected only by filing a financing statement, U.C.C. § 9-304 official comment 1 (1978). See cases cited *supra* note 228.

232. See NELSON & WHITMAN, *supra* note 3, § 5.27 nn.5-13 and accompanying text.

233. See cases cited *supra* note 229; NELSON & WHITMAN, *supra* note 3, § 5.28 n.40.

234. See NELSON & WHITMAN, *supra* note 3, § 5.27 nn.5-13.

they must search there. No policy is served by forcing everyone to use both a belt and suspenders. The court, we suggest, should have simply carried the mortgage law analogy to its logical conclusion by finding the Code filing sufficient for complete perfection. The only objection to this view is that it is contrary to long-established habits in many areas; but once the law is clarified, those habits can be changed.

One caution must be added. Installment contracts are not always recorded, and a vendor quite conceivably will enter into one and later purport to mortgage the land as security for a loan, say from a bank, without disclosing the contract's existence. In a formalistic sense, such a mortgage is of the vendor's interest in the contract, and hence should be perfected under article 9 as suggested above. But in practice this requirement makes no sense if the bank has no notice of the contract's existence. Indeed, the bank will have no reason to suppose that anything other than the land itself is serving as its security, and will have no idea that article 9 is involved in any way.

In this situation applying article 9 would be manifestly unfair. The bank should be held to article 9's perfection rules only if it is on actual or constructive notice from the recorded contract or the vendee's possession that the contract exists. Imposing constructive notice on the bank entails no extra burden in this setting. The bank will normally search the realty records and obtain title insurance when its borrower presents it with what purports to be a mortgage on fee simple ownership.

Whatever its merits, *Freeborn* and its progeny exist and cannot be ignored. Until the law is further clarified, those who take security interests in the installment vendor's rights are well advised to record some appropriate instrument—a deed, an assignment of contract rights, or both—in the real estate records and file a financing statement. The added expense and inconvenience of following *Freeborn* seem a small price to pay for the enhanced protection the vendor's creditor will get as against third party claimants.

XIII. CONCLUSION

Traditionally the forfeiture remedy available under installment land contracts has involved substantial risks for vendees and considerable benefits for vendors. In modern practice, however, the risk allocation has changed. When forfeiture occurs, it may still have harsh, even devastating, economic effects on

vendees. But at the same time the uncertainty which infects the vendor's rights has become nearly intolerable. A declaration of forfeiture is often nothing more than an invitation to litigate. If the vendee is willing to roll over like a dead dog, forfeiture may be an attractive remedy. But where the vendee proposes to stand on his rights, the contract suddenly begins to lose its luster for the vendor.

Uncertainty pervades other aspects of the contract as well. Few vendors or vendees can be certain about the best way of documenting an outright transfer of their interests, and creditors who wish to take security in those interests are in an even more murky situation. The vendor who has carried off a successful forfeiture may still face uncertainty as to the proper method of clearing his title of the now-defunct, but recorded, contract. These problems were solved by mortgage law decades or even centuries ago; but for installment contract parties, they are live and thorny issues.

In most states in which installment contracts are heavily employed, the driving force behind their use is a cumbersome and costly judicial foreclosure process for mortgages. Where nonjudicial power of sale foreclosure of mortgages or deeds of trust is available, the incentive to use the installment contract simply disappears. The trend of the law, which we applaud and encourage, is the enactment of well-drafted power of sale legislation which permits reasonably speedy and inexpensive realization on real estate security. If this movement continues, the installment contract may eventually be relegated to the position it deserves as a relic of legal history.

